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3

Marko Seppä

STRATEGY LOGIC OF THE VENTURE CAPITALIST

UNIVERSITY OF JYVÄSKYLÄ

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Understanding venture capitalism - the businesses within - by exploring linkages between ownership and strategy of venture capital companies, over time, in America and Europe

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To the spirit and memory of

ILKKA SEPPÄ

* 14.1.1940
† 29.9.1999

ABSTRACT

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This inductive, exploratory study is aimed at understanding venture capital as a *business* phenomenon, as *someone's* business. The mission is to contribute to strategising both *inside* and *outside* venture capital companies. The study centres around the 'doctor' whose serum - properly diagnosed, dosed, and injected - shields nations against economic retardation. Defined broadly, venture capitalists are a diverse community ranging from private individual investors to government-owned institutions and from entrepreneurial teams to publicly-held corporations.

Empirically, the study investigates missions, organisational and legal structures, and product-market strategies of *differently-owned* venture capital companies. The objective is to investigate *who* are in business, in venture capital, *why* they are in business, and *how* they are in business. Methodologically, the study builds on a synthesis of four different approaches. *Conceptual constructing;* aimed at creating a theoretical framework of venture capitalist strategy logic; largely derives from the researcher's own industry career (1986-1996) and is interdisciplinary by nature. *Historical review;* aimed at sketching archetypes of venture capitalist strategy logic; investigates literature from a variety of perspectives with an emphasis on the industry's launch and evolution in America. *Survey exercise;* aimed at probing the archetypes; comprises of industry surveys conducted in Finland (1989, 1992, 1997) and America (1992). *Case study;* aimed at further probing the theory construction; focuses on the Finnish market and follows two companies through changes of owner-type deriving from case interviews conducted during 1993-2000.

Key findings: (i) Venture capital is an *ownership* (rather than finance) related phenomenon involving *owners* emerging between *managers* and *investors;* (ii) the buyers of venture capitalists' portfolio stakes, labelled *consumers*, are the 'forgotten' stakeholder group of the venture capital process; (ii) success in fund-raising, entering, value-adding, and exiting transforms into *venture capital spiral* of institutionalisation; (iv) the venture capital phenomenon employs not one business concept, but several, illustrated by six *archetypes of strategy logic;* all culminating into differences in dynamics with vast implications to the industry's stakeholders.

Keywords: venture capital, business ownership, ownership management, corporate governance, entrepreneurship, strategy

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PREFACE

Had I been foretold (back in the 1980s) that, before I ever defend a thesis, *the USSR will collapse, the Baltics regain independence, Germany be united, Finland join the EU, and the EU launch a single currency,* I would never have started this project. No, I do applaud every change; I would merely have concluded that I would *die of old age* before I ever get to defend. Nevertheless, all this has materialised; or almost; since I am still writing a preface. Besides my research taking time, this illustrates even more the exhausting pace and extent of change in Europe during the last decade of the second millennium.

Marked by the successful launch of the euro, *Western* Europe is taking a leap towards an effective single market, and is witnessing an unforeseen wave in cross-border M&A activity as a gravity effect. Simultaneously, *Eastern* Europe has shifted away from a collective ownership idea to a private enterprise system. In the process, the control to an unforeseen extent of property has changed hands. Change of ownership, and the management thereof, have become crucial issues for the whole of Europe. Successful cross-border governance is an ever tougher challenge both to *investment managers* and *corporate managers.* In fact, we may have witnessed *such* an era of shareholder activism that an *ownership management* cadre has permanently emerged between the two. In this study, an archetype of venture capitalist strategy logic labelled *interim-owners* was discovered and depicted to portray the new profession.

This research started (in fact) already in 1987, when I *had to pick a topic* for a B.Sc. thesis. A year before, I had entered (as 'apprentice') a privately-held Finnish *kehitysyhtiö*. The company was working on an exiting new *business idea,* booming in the country thanks to a fiscal incentive scheme and the liberation of the financial market. With great enthusiasm I decided to make scholarly sense of this fresh *Finnish* business phenomenon. Little did I know, at the time, where it was coming from and less still where it was heading. As years went by, the object phenomenon expanded, conceptually, to cover *all forms* of *venture capital* - the global metaphor for economic progress and job creation - and the transformation process thereof in America and Europe. Eventually, a link was established between venture capitalism and shareholder activism and the concept of *ownership management* emerged for an early theory proposition.

Today, with my research mission finally completed, I still stand in front of a phenomenon calling for inductive, exploratory adventuring; but such a journey cannot be initiated at a desk. If not for a personally experienced impulse from *reality,* a personal interest and access to observe from *within,* it is tough to engage in such an exercise. My opportunity to follow developments from *within* (during 1986-1996) has, thanks to the wheel of history, converted a study on a local isolated European market to one of more global orientation. While I hope my research bears fruit beyond *Finland* and the *Finnish understanding of venture capitalism,* even 'only there' the ROI of this engagement would be 'fully satisfactory'.

ACKNOWLEDGEMENTS

My research has, since my apprenticeship years, benefited from the guidance and support of several outstanding individuals – mentors, sponsors, colleagues, and friends; both from academia and business – without whose intellectual and financial contributions this dissertation would never have been completed. Hence, besides these few lines of expressed gratitude, this whole report stands as a tribute to the men and women who kept me going through the 'rain of the academic marathon'. It is fair to note, however, that every interpretation and flaw herein is the sole responsibility of the researcher.

Professor Juha Näsi stands out as the one person to whom all of the attributes above can be attached; whose belief in my project remained strong ever since its earliest stages. Specifically I thank Juha for his insight of bringing me inside the JYU corporate strategy faculty (full-time) in 1997, after intensive four years of venture capital partnership. Towards the finishing line, professors Michael Ensley, Markku Lahdenpää, Pekka Tuominen, and Tyzoon Tyebjee decisively and constructively guided my closing of the book – for which I am forever grateful. While lecturing at the JYU, I feel every colleague cared enough to make a personal contribution: Matti Koiranen, Minna Koivunen, Johanna Kujala, Anna-Maija Lämsä, Salme Näsi, Pasi Sajasalo, Taina Savolainen, Tuomo Takala, Mika Tuunanen, Petri Vehmanen, and Asta Wahlgrén, to name just a selected few of my sparring partners. The enthusiasm of many of my own corporate strategy students inspired my work during its final stages.

At my alma mater, the University of Tampere (UTA), professor Tauno T. Mäki was the first to encourage me to continue towards a Ph.D. in 1989. Before retiring, he had seen me through compulsory course work (soon after which my industry career froze my research for four years). I am grateful for my years at the UTA (the undying 'Amiraali' spirit) and particularly indebted to professor Tarmo Pukkila who encouraged me to complete half of my course work as a visiting scholar at the University of Oregon, during 1990-1991. Consequently, my Ph.D. is a product of three universities – each worthy of special praise. Over the years, my study has also greatly benefited from interaction with several distinguished scholars: McRae Banks, Warren Brown, William Bygrave, John Darling, Alan Grant, Anil Gupta, Frank Hoy, Morten Huse, Iiro Jahnukainen, Pertti Kettunen, Takeru Ohe, Arja Ropo, Michael Russo, Harry Sapienza, Donald Sexton, Malcolm Smith, Risto Tainio, Jeffrey Timmons, and Markku Virtanen, to name just a few. My warmest thanks.

Besides academicians, my study has been contributed to by a variety of practitioners: Venture capitalists, entrepreneurs, investment bankers, and public policy makers. First of all, I am indebted to Pasi Asikainen, the founder of Panostaja Oyj, who engineered my apprenticeship program in 1986, encouraged towards a Ph.D., and offered to pioneer venture investing in the former Soviet Union in 1991. I also warmly remember the encouragement of all my other colleagues from my years at Panostaja (1986-1993).

I thank my ex-partners of the FVC era (1993-1996), Gisli Reynisson (who worked with me already on the 1992 survey) and Juha Sarsama, for a daring team-entrepreneurship adventure; and Tapio Niemi (our ex-managing partner) and Thominvest Oy (our ex-corporate partner), who joined at a later point, for a most educational partnership. I wish to express my special gratitude to L.J. Jouhki and Timo Jouhki for the opportunity Thominvest's participation created.

The importance of the effort and time donated by the respondents to the four industry surveys (in Finland and America during 1989-1997) and the individuals interviewed for the case study (in Finland during 1993-2000) could not be overemphasised. My deepest gratitude. I thank the EVCA, the FVCA, the NASBIC, the NVCA, and Venture Economics, Inc. for their kind co-operation in conducting the surveys. My special thanks go to CapMan Capital Management Oy and Sponsor Capital Oy for the many good years of case co-operation.

During 1993-1996, Ilse Haverinen, Piretta Pylkkänen, and Hanna Rantanen candidly processed data related to the case study and, in 1998, Lea Nevalainen related to the survey exercise. The 1997 industry survey was conducted as a joint venture with Pekka Uusi-Autti. In 1999, Pentti Nyblom guided my statistical analysis of the entire survey exercise and, in 2000, Satu Virtanen reviewed the 'British' of my final report. My heartfelt thanks to each of you. I also thank my personal friends for their important role during the years gone by: Believe me, without *you* this would have been an almost unbearably lonely project.

My research has required significant financial backing. Besides my past employers, I stand the most indebted to Finnish Foundation for Economic Development for their sponsorship from launch through America to completion. I am greatly indebted to the Helsingin Sanomain 100-vuotissäätiö, the Jyväskylän kauppalaisseuran säätiö, and the JYU for their financing of my study's critical final stages; and to the Tampere Foundation for Economic Development, Finnish Cultural Foundation, Tampere Chamber of Commerce, and the UTA for their financial support during the earlier research stages. Important first sponsorship came from the 16 venture capital companies that subscribed for a hard copy of my M.Sc. thesis in 1989.

On January 14, 2000, the day he would have turned 60 years old, I decided to dedicate my thesis to the spirit and memory of Ilkka Seppä, without whose unrelenting parenthood and example which I enjoyed for over 30 years I believe I would never have accomplished this goal. My wonderful mother Sinikka I can never thank *enough* for everything. And I cheer my 'little' brother Jari who, 'from teenager to executive', kicked butt and cherished at times of blues. At home, my one and only, beloved Sirpa provided all the room, space, and patience required by my slowly-evolving research adventure. And – as much as this thesis is a love child – the births of Lassi and Susanna, during the process, helped me bring this book to life, too. Of which I am thankful to God.

In Lempäälä, May 5, 2000

Marko Seppä

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1 INTRODUCTION

This work is about understanding venture capital as a *business* phenomenon; as *someone's* business. The study investigates *who* are in business – in venture capital – *why* they are in business, and *how* they are in business: From the *past* to the *present*, from *America* to *Europe*.[1] Throughout the field's existence, including its extensive growth this past decade, our interest has been in the impact of venture capital to all other stakeholders of the phenomenon but the ones who make it happen. Consequently, we have a wealth of knowledge of *implemented* strategy, but very little of the logic behind it. Of *whose* logic it is, to begin with.[2]

The mission of this study is to contribute to strategising both *inside* and *outside* venture capital companies. Besides the *owners* and *managers* of venture capital companies, also their *investors* and *investees*, as well as the *buyers* of their portfolio interests, and *government policy makers*, make strategic decisions concerning the venture capital firm. Empirically, the study investigates missions, structures, and strategies of *differently-owned* venture capital firms. Theoretically, propositions for a general conceptual framework, and archetypes, of venture capitalist strategy logic are constructed, and an initiative regarding the newly emerging role of *owners* in corporate strategy reality is formulated.

According to the underlying thesis of the study, the *ownership* of a venture capital company constitutes the foundation of venture capitalist strategy logic. Each foundation of strategy logic is like a ship one sails on unknown waters in search of new worlds: It is difficult to modify or repair without docking and a high cost, and mere size protects one only until one hits an iceberg. This is why we only hear success stories of adventurers who *both* built *and* steered their ships right.

---

1 Besides the continents, *America* is used to refer to the US and *Europe* to the EU.

2 The study joins an emerging theoretical discussion of the field addressing questions such as: Why do venture capital companies exist? (Amit, Brander, and Zott 1998), and: Do venture capitalists really understand their own decision process? (Zacharakis and Meyer 1998). The latter put *the motto of this study* in words: "Any improvement in understanding (which ultimately leads to improved decision-making) can have a huge economic impact for both the venture capitalist community and their funded ventures."

1.1 In search of the venture *capitalist*

> "The *entrepreneurial firms* and the *venture capital* are the great advantages you (Americans) have." Jiro Tokuyama, a Japanese economist (Bygrave 1989: 4).[3]

Ever since World War II, starting in America, injections of *capital* in progressive entrepreneurial *ventures* have launched successful new companies and entirely new industries - such as microelectronics and personal computers - and revolutionised existing ones. [4] New jobs and exports, whole new competitive advantages of nations, have been witnessed to emerge from the *venture capital process* – at the heart of which are the purchases, active ownership, and eventual sales of equity positions in selected private enterprises. [5]

After the fall of the USSR and communism in Europe, *venture capital* has become a metaphor for economic growth, vitality, and job creation also throughout Europe. Due to its potential economic impact, it is depicted by governments as *something* comparable to a precious *medicine* or growth serum - and, some insist, the more the merrier. Consequently, since the late 1950s, governments have taken various measures to foster the growth of local pools of the drug. Nearly as often as the measures taken have resulted in *quantitative* increases in venture capital activity, there have been *qualitative* concerns; disappointments regarding the hoped-for economic impacts; however.[6]

Not for long a *quantity* problem - there being ample pools of venture capital available - Europe still remains somewhat puzzled over the old continent's 'immunity' to the drug, when compared with America. In 1997, the European Union took on a Danish initiative (of which an excerpt below) to benchmark Europe against America's (and Israel's) best practice.

> "As an illustration of the spectacular performance of [America], in creating high technology based new businesses, ICT will soon become the largest industry in [America], and the one where it leads the rest of the world by the greatest margin. This success has come about partly as a result of the strength of the [American] *innovation financing system* in which the vast majority of the most successful firms have been financed, nurtured, and sometimes even managed by *venture capital*. By contrast, much of Europe's technological development has resulted from late stage development and exploitation of innovation of existing products by large corporations. Moreover, in most of Europe it is very difficult to not only find innovation financing but, even more importantly, to turn particular new technology based projects into viable businesses" (Danish Ministry of Business and Industry 1997; emphasis added).[7]

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[3] Original source: Gevirtz (1985). Emphasis added.

[4] Among the early legends, in America, are the investments that created Digital Equipment Corporation, Apple Computer, and Federal Express (Bygrave and Timmons 1992: 1-3).

[5] For a seminal exposition of the management process of a venture capital firm, see Tyebjee and Bruno (1981).

[6] From the SBIC experiments in America (see chapter 4) to the *kehitysyhtiö* experiments in Finland (chapter 6).

[7] The words of Bylinsky (1976: 3) from over twenty years ago have preserved value: "Oddly enough, in this era of tremendous technological achievement there is still mystery about the process by which new ideas can be translated into tangible products, business, and profits."

The best-established explanations as to why venture capital has worked better in America than Europe relate to differences in *market environment*: Europe's multiple currencies, less developed stock markets, language barriers, local differences in consumer behaviour, and less growth-oriented entrepreneur communities (noted originally by Tyebjee and Vickery 1988). [8] More recently, these were confirmed in the EU commissioned report referred to above (Bannock Consulting 1998). In other words, it is well established that the *quality of the playground* has to do with the economic impact of the venture capital drug. The deepening integration of Europe is likely to serve this end by eliminating currency speculations and many direct cross-border costs, to begin with.

Interestingly enough, concerns over drug efficiency or, more precisely, drug *allocation* have been raised on the new continent as well. During the observation period of this study, since 1987, the field has reportedly turned *less venturesome* also in America.[9] The drug is no longer *mainly* prescribed in *small doses* to high-technology based entrepreneurial start-up ventures there either. It rather goes to enable management buyouts of more established businesses, even to privatise poorly-performing public corporations. The sizes of venture capital funds raised on the market and, consequently, the sizes of minimum investment of even the classic venture capital investors have grown to such a level that it has become technically difficult to prescribe and inject the drug in such (small) doses that created many of the industry's greatest legends.[10] The "Macmillan gap", discovered in 1931 by a government study in the UK, is again a reality.[11] In their landmark book: *Venture capital at the crossroads*, Bygrave and Timmons (1992) ponder to the point: "Where is the *venture* in venture capital?"[12]

From another angle, the change in 'drug allocation' from classic towards larger and later stage deals, referred to above, is not the most dramatic development in venture capital since its inception and export across the

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8 Penrose (1968) already acknowledged that the growth of small firms "may be more controlled by the environment than by the qualities of resources or the enterprise and ingenuity of entrepreneurs." Indeed, why would venture capital organisations, typically small and often entrepreneurial, be an exception?

9 Amit, Glosten, and Muller (1990) note this with special concern because, in their judgement, America relies on the venture capital industry more heavily than Europe and Japan.

10 In 1957, American Research & Development Corporation (ARD) invested $70,000 in a new venture started by four MIT students, launching Digital Equipment Corporation, valued, by 1971, at $355 million. In 1975, Arthur Rock invested $1.5 million in a start-up that launched Apple Computer, Inc.; an investment that was valued at $100 million at the company's initial public offering (IPO) in 1978. (Bygrave and Timmons 1992: 1-2.)

11 The 'capital gap' problem, discovered and documented already 70 years ago (Dominguez 1974: 3), is today faced by entrepreneurs seeking for less than $5 million in early-stage funding. It recently made a central topic at the Santa Clara University 1999 summit: *Financing New Ventures – Gaps and Gateways*. When the present study was launched, the *average* investment of NVCA members was $865,000 (Maier and Walker 1987).

12 As noted by Elango, Fried, Hisrich, and Polonchek (1995), the issue has become raised of how to define *venture capital*. Whereas Bygrave and Timmons (1992) find the differences between early-stage and late-stage investing so great that investors focusing on the latter should not be considered venture capitalists, e.g., Morris (1992) underlines that the industry engages in both. While this study *conceptually* follows the reasoning represented by Morris (1992), it also shares the concerns of Bygrave and Timmons (1992).

Atlantic. This may even be a consequence of another change; *change in the quality of the doctors in charge* (the ones who *diagnose, dose* and *inject* the drug, and *monitor* its effects), i.e., the venture capitalists. Today, not only wealthy individuals and teams of sovereign general partners deal with the drug as 'performing doctors', but also corporation/government-owned *institutions.*[13] In other words, *control over the venture capital process has shifted (simplified) from individual principals to diverse groups and layers of agents* – just as has happened in business in general.[14] While some previous inquiries have insightfully been in search of the *venture,* in venture capitalism, this one puts the weight on the latter word being a search for the *capitalist.* Hence, the focus here is on the *doctors,* not the drug; on *who* they are, *what* they are after, and *how.*

Recently, research on the role of venture capitalists in the modern economy has been on the rise. In their study on why venture capital firms exist, Amit, Brander, and Zott (1998) conclude that this is due to venture capitalists' ability to reduce the cost of informational asymmetries. They do not, however, make any conceptual difference between the concepts of venture capital company and venture capitalist. *In this research, a venture capitalist has been defined as the controlling owner of a venture capital company.*[15] The study owes the insight, in fact, to the Finnish media. In 1987, a bitter-sweet, and hence the more eye-opening *Kauppalehti* causerie (of which an excerpt below) reported early experiments with the drug, and the doctors, in the Finnish arena, titled: "Mission of the venture capital company."

> "A few years ago, a hot *business idea* circulated the world and the nation: Let's put money into small firms with great future potential and cash out the stock once the firm value has increased. *Let's establish a venture capital company.* Socially respectable and honest business that brings home nice profits. So it was believed. Reality is different... It is typical of venture capital companies to sell services to their portfolio firms... Portfolio firms have to pay for having the day's work undone and the staff listen to the same old boring consultant stories. The situation is absurd. *The only explanation for the empty-minded force-selling [of services] is that the short-sighted venture capital companies have to generate revenues."* (Kauppalehti, 9 November 1987: "Kehitysyhtiön tehtävä", emphasis added; for full text see appendix 1).

In Europe, venture capital has been typically depicted and approached as a *system* or mechanism (rather than someone's business) and discussed in the passive form (as in Danish Ministry of Business and Industry 1997). This has been the case since the import of the concept to Europe in the 1960s, when it was introduced in many countries as a public sector vehicle for SME sector

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13 "Not long ago, the industry of providing risk money could be classified as a jumbled group of individuals with no central organisation – the most peculiar business in [America]" Klaasen and Allen (1980: 4).

14 Echoing Amit, Glosten, and Muller (1990): "Under the current institutional structure of the venture capital industry, the most promising entrepreneurs will not seek venture capital financing, and are likely to make slower progress in the development and commercialisation of emerging technologies... Thus, this study calls for close collaboration among researchers and practitioners in finding new structures of venture capital regimes that will foster venture capital financing of the most promising entrepreneurial firms."

15 See appendix 1 for evolution of the topic.

development. Venture capital can hence be argued to have emerged as a *drug-centred* phenomenon in Europe; one with more of a faceless, institutional image. In contrast, in America, where self-made men have enjoyed more admiration than in Europe, venture capital can be argued to have emerged more as a *doctor-centred* phenomenon.[16] A classic discussion on the role of the doctors of venture capital is provided by Brophy (1986) in "Sexton & Smilor (eds.): The Art and Science of Entrepreneurship" (emphasis added).[17]

> "To put the role of venture capital in context, it is useful to think of it as a key part of the economic growth process now facing the United States and other countries as well. The venture capital process is important in marshalling resources for the attainment of benefits for government, business, and the public at large... *It is... to the point to think of the [venture capital] financier as the overseer of the market exchange system, in a sense deciding through financing decisions, on behalf of society at large, which new projects should go forward and which should not.* This is an important function in the economic transition now facing many economies. It is unlikely that a country or area can be competitive in commercial exploitation of innovative processes, products, and services without a strong local venture capital community."

Consequently, when strengthening a local venture capital community in Europe, attention has been placed on the quantity of the drug and the 'technical aspects of the medication process' rather than the quality of the doctor. While the basics of institutionalisation of venture capital, the rise of agency questions, have been recognised (Sahlman 1990, Bygrave and Timmons 1992), the effect of the transformation of the venture capitalist's *person* on venture capital as a *business* has remained unexplored. As Virtanen (1996: 59) points out, there have been several investigations on *how* the venture capital companies behave (such as Bannock Consulting 1998), but extremely few on *why* they behave so. The make-up, *ethos*, and logic of action of the different types of venture capitalists have enjoyed no wealth of scholarly attention; almost as if these were a *box of Pandora*.[18] Nevertheless, given the revitalising power vested in the venture capital serum, we should *dare and do our utmost* to prevent 'drug abuse' and license only *rightfully-qualified* doctors.[19]

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[16] While, in America, *venture capitalist* typically refers to a *natural person*, often a partner of a venture capital firm, in Europe it often refers to a *legal person*, an institution – unless used to refer to their hired management in an analogy of calling hired managers *boasting entrepreneurial characteristics* entrepreneurs. In many European languages, e.g., Finnish, German, Swedish, there are no functioning translations for *venture capitalist*, in the first place. The word *capitalist* (it appears) is 'no popular' expression in many of the languages.

[17] Timmons and Bygrave (1986) note how ironical it is that the "capital" in venture capital is the least important ingredient in fostering technological innovation; how the field is, instead, "management intensive."

[18] While Jensen and Meckling (1976) refer to the firm, in general, as a "black box," it may be appropriate to refer to the *chief overseer firm* as something even more drastic. According to Webster's Ninth New Collegiate Dictionary, *ethos* means "the distinguishing character, sentiment, moral nature, or guiding beliefs of a person, group, or institution," and *Pandora's box* "the box sent by gods to Pandora, which she was forbidden to open and which loosed a swarm of evils upon mankind when she opened it out of curiosity. A prolific source of trouble."

[19] In a market economy, there is no *public ground* for critical evaluation of the management of the venture capital process when it is both law-abiding and solely based on private

> "To understand venture capital, one needs to understand the philosophy that drives the venture capital firm. The objective of a venture capital firm is to generate long-term capital appreciation through debt and equity investment in small and medium size businesses. Even though the venture capitalist assists in the creation of jobs and the economic development within a region, the important driving factor is the realisation of substantial capital gains." (Davis 1986: 108.)

This study aims at providing an understanding of differences in the quality of doctors in order to make it easier for each individual stakeholder to define a rightfully-qualified doctor for their particular need. Although it is no objective of this study to produce normative propositions, implications that could be so interpreted are not being overly avoided either. Drawing from the researcher's industry experience (1986-1996), in general; and industry historical, survey and case data (collected during 1987-2000), in particular; the study ponders upon and explores venture capitalism as *a business of owners*. The study digs into the origin of strategy logic of the different venture capitalist types, and the transformation process thereof, over time, in America and Europe.

Venture capital is a young industry, less than 60 years old. For the first 30 years, it was solely an American phenomenon, influenced by American ideals and opportunities only - the post-war spirits, conversion of military technologies and production for consumer applications, and fast economic growth of a large homogenous single market - and the American venture capitalists. Much of the global conceptualisation of the venture capital phenomenon still derives from those early days. From a European perspective, only the past two decades - culminating in the founding of the European Venture Capital Association (EVCA) in the early 1980s, the fall of communism and the USSR at the 'mid-way', and the ongoing introduction of the euro - have made venture capital a truly pan-European phenomenon. [20] In retrospect, there could hardly have been a more rewarding period, than the past thirteen years, to experience, observe, and explore the field in-depth, re-consider its conceptual foundation, and draw conclusions.

Well onto 2000, Europe has a historical opportunity to prepare for the final coming of the euro by building an increasingly pan-European *venture capitalist* community; the importance of which is underlined by the Commission of European Communities (1998):

> "Developing risk capital in the European Union leading towards the development of pan-European risk-capital markets is essential for major job creation in the EU. Although the EMU and the arrival of the Euro will create a more favourable environment and be a major catalyst for change, there remain a number of pernicious barriers - regulatory, economic, fiscal, cultural - that need to be addressed as a matter of urgency. In essence, what is at stake is the creation of a new entrepreneurial culture in Europe. The real political challenge is to provide the tools, enabling technologies and financial instruments for a new generation of European

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sector capital (i.e., utilising no governmental subsidies or incentive schemes which - on the other hand - is rarely the case in the modern market environment).

20 Twelve years ago Tyebjee and Vickery (1988) discovered a Western Europe "in the process of entrepreneurial renaissance." Soon thereafter the renaissance had spread across Europe, all the way to the Ural Mountains.

> entrepreneurs to start up and succeed. To provide the conditions for European diversity to flourish. So European skills and knowledge can be translated into winning global companies. To create sustainable jobs and additional growth. In the European Union. The Commission considers the provision of substantial pan-European risk-capital markets a necessary condition for this to happen."

Europe is not up against an easy task, however, so vastly has the field expanded, changed, and diversified - and grown in global economic significance - during this research period alone. Venture capital is, at the same time, a *holy grail* and a *Pandora's box* for the integrating economy. It is a metaphor for economic growth and job creation but, at the same time, something mysterious and inaccessible - a closed world of its own.[21] A world, located between the ears of venture capitalists, which we can investigate only by interpreting their spoken words and physical action. Yet, this world we have to enter to better understand the business.

As says the venture capitalist who backed Intel and Apple: "Strategy is easy, but tactics - the day-to-day and month-to-month decisions required to manage a business - are hard... Good ideas and good products are a dime in the dozen. Good execution and good management - in a word, people - are rare." (Rock 1987.) This is why the present study zeroes onto the person of the venture capitalist; natural or legal; the kind of people they are.[22] Building from the inside of the venture capitalist's world, this study seeks to further demystify the industry by opening up its players, describing its processes, and illustrating its dynamism. At best, the results benefit venture capitalists and their stakeholders - both theory and practice - alike.

> "Finally, one must ask: 'How do the benefits that venture capitalists provide as intermediaries compare to the costs'. While we show that the role of an intermediary is valuable, the [venture capital] style of investing has high costs... More empirical work will be needed to explore in what situations venture capital costs are justified." Fried and Hisrich (1994).[23]

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21 Since Timmons and Gumpert (1982), the "myths" of venture capital have been acknowledged and addressed.

22 Stevenson, Muzyka and Timmons (1986) conclude: "Judgement quality [of the venture capitalist] is key, and no simulation model and no single short-term qualitative measure will adequately capture this most critical asset in venture investing." Bourgeois and Eisenhardt (1987), who studied the anatomy of a failed (high-tech) venture capital investment, conclude: "A careful, analytical decision process, undertaken by a collegial group of executives, is not enough for firms in high-velocity, high-technology environments. Successful firms deal with the competing tensions of analysis and speed, autocratic and collegial power, and innovation and incrementalism. Managing firms in high-speed environments is more like playing a constantly changing video game than it is like playing chess, where the rules are fixed and there is time to contemplate each move." This would perhaps not be all that far-reaching conclusion concerning the management of *venture capital companies themselves*, either.

23 As pointed out by Sexton (1986), *entrepreneurial* firms - defined as *growth-oriented* firms - play an important role in the economic development of an area. Not *all* firms play such role. Jarillo (1989) emphasises the ability and willingness to use external resources as the essence of entrepreneurship. How about venture capitalism?

1.2 Objectives, limitations, and structure of the study

> "Every enterprise needs a concept of its industry. There is a logical way of doing business in accordance with the facts and circumstances of an industry, if you can figure it out. If there are different concepts among the enterprises involved, these concepts are likely to express competitive forces in their most vigorous and most deciseve forms." Alfred Sloan (Robert 1988: 20).

The purpose of this research, at its broadest, is to make sense of venture capitalism as a business phenomenon (as someone's business) and understand the businesses within. Hence the thesis that (1) *our understanding of the venture capital phenomenon is insufficient.*

Second, and an extent more concretely, this is an effort to open up and redefine the venture capitalist, conceptually, by analysing the ownership and legal structures of venture capital companies - **who** own, and have owned such entities, over time, in America and Europe - and by putting them in 'pigeonholes'. Hence the thesis that (2) *we have been missing a point when defining a venture capitalist.*

Third, on a yet deeper level, the study involves an attempt to explain **why** venture capital companies exist; what the owners want from their companies. The venture capital process is addressed, as a whole, to understand missions and *true* product-market strategies of the differently-owned venture capital companies. Hence the thesis that (3) *our picture is incomplete as to what the world's venture capital companies do for their living.*

Fourth, to serve a markedly practical end, aimed at producing a new tool for strategising around venture capital companies, the study investigates **how** the differently owned venture capital companies are structured, governed, and organised - and *how* they vary by strategy logic - folding the findings into a general framework and archetypes of venture capitalist strategy logic. Hence the thesis that (4) *there is a need for new management tools in the venture capital industry.*

Finally, the study seeks contributions for the theory development around the venture capital company, in the corporate strategy context. With the aim of linking the developments observed in the field of venture capital to the topical theoretical discussion concerning the newly emerging role of owners in corporate reality, the study aims at a new proposition on the roles of owners, investors and managers of modern corporations. Hence the thesis that (5) *the recent developments observed in venture capital can advance our theory of the firm.*

The key research question can be compressed into the following: ***Who are in business in venture capital, why are they in business, and how are they in business; and what is their business: What do they produce, how, and to whom?*** Empirically, this can be described as *a study of linkages between ownership and strategy of venture capital companies, over time, in America and Europe.*

Being addressed in the study are - *holistically* - the venture capital process as a whole (rather than specific phases of the process) *and the logic behind the whole.* Figure 1 presents the initial conceptual framework of the study.

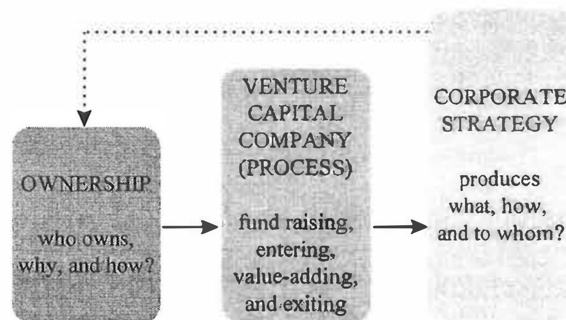

FIGURE 1 Key conceptual issues of the study: An initial framework

Is our understanding of the venture capital phenomenon insufficient?

This is a matter of definition, to begin with: What is meant by *venture capital*? In the language of this study, it involves every business employing the venture capital process, i.e., where capital is pooled for equity investments in private or to-be-privatised enterprises in order to add value to the holdings as an active owner and with the aim of realising the value-added in an exit after a medium-term ownership (ca. one to ten years). Our understanding of this phenomenon is not sufficient, if we realise we have failed to follow, understand, or accept the transformation and diversification development of the field over the decades gone by.

Venture capitalists are increasingly active in leveraged buyout (LBO) acquisitions, marked with concern by many. Yet, their expanded role could be of increased value to an economy. As pointed out by Jensen (1989a), the LBO transactions - symbolised by KKR's $25 billion privatisation of RJR Nabisco in 1989 - are only a tip of an iceberg, a much larger phenomenon not yet well understood. Fundamentally, the phenomenon is seen as a reflection of agency problems, the conflict of interest between shareholders (principals) and management (agents) set forth by Jensen and Meckling (1976).[24]

> "Though controversy surrounds them, and despite the fact that they are not all productive, these transactions are the manifestation of powerful underlying economic forces that, on the whole, are productive for the economy. Thorough understanding is made difficult by the fact that change, as always, is threatening - and in this case the threats disturb many powerful interests" (Jensen 1989a).

Many observers of venture capital, academicians as well as politicians, have been frustrated to see the field turn less venturesome; Bygrave and Timmons (1992) find it at a crossroads having to decide what directions to follow into the future. The crossroads, however, is of different shape depending on where one

24 Interestingly, Weidenbaum and Vogt (1987) point attention to the fact that the same potential for conflict of interest between shareholders and management exist between the acquiring firm's shareholders and management. Venture capital companies, as such acquirers, are not free from such concerns either (see Sahlman 1990).

stands to view. From an American perspective, it is a nearly 60-year-old industry, which only 'recently' has experienced changes in the investment spectrum. From European perspective, with a less than 30-year history of organised venture capitalism, the full investment spectrum appears easier to absorb and address. Since much of the *existing* (sometimes inefficiently allocated) economic resources of an economy rest in the more mature, often publicly-held or state-owned enterprises, the economic impact derived from the *expanded role* of venture capital companies - investments in more mature businesses - should not be belittled either.

Besides disappointments on the political level - regarding the general economic impact of venture capital - entrepreneurs have signalled reservations concerning venture capital, at least in Finland. They have appeared sceptical about the value-added related to a venture capitalist's participation in their businesses. This can be seen as another sign of insufficient understanding (or concern) of *what* venture capital is essentially about.

Venture capitalism has outgrown its classic definition. This observation is important from the perspectives of both theory and practice. Strategists of venture capital companies, their investors, investee entrepreneurs, as well as government policy-makers need an up-to-date understanding and a mutually-shared conceptualisation of the phenomenon for their economic decision making. For scholars, the observed changes in the behaviour of venture capital companies offer contribution-potential to the existing base of knowledge. This study attempts to help the students, as well as managers of venture capital companies, and their stakeholders, to approach and understand venture capital as the diverse, global business it is today. Although several steps have been taken in venture capital research before and even during this research project, not enough remains accomplished in terms of accepting, let alone understanding the recent changes in venture capital investing world-wide.

Much of the research on venture capitalism conducted to-date has focused on one aspect of the phenomenon only - such as the characteristics of investments made, or the criteria used to make investment decisions - rather than the whole. The tips of the iceberg, or the small windows that such secluded aspects can open on the whole phenomenon, may have helped to see trees, and their growth, but not the forest and the diversification thereof (see figure 2).

Zacharakis and Meyer (1998) criticise studies on venture capitalists' investment decision criteria for not being attached to theoretical frameworks; the lack of which was already acknowledged by Tyebjee and Bruno (1984) in their landmark study on the topic. Hence, the words of Brophy (1986) have preserved their value throughout time.

> "Research on venture capital and the emerging growth company have fallen short of comprehensive understanding of the processes involved... Despite... evidence that the operation of a venture capital fund is becoming increasingly complex, little systematic study of managing the venture capital fund has been done. This area is rich in research questions given the problems in agency, conflict of interest and objectives, and investment monitoring that abound."

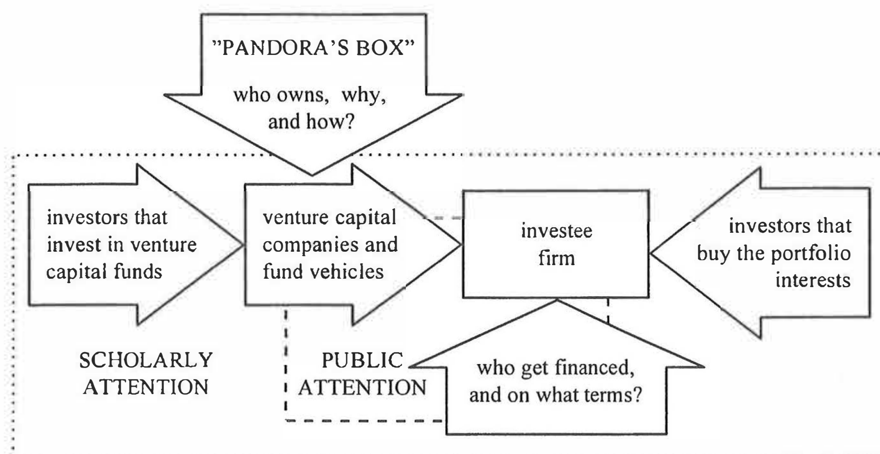

FIGURE 2 Status of public and scholarly attention on the venture capital phenomenon

Whereas valuable work has been done on the role of venture capitalists as agents of their funders or their investee entrepreneurs, very little research attention has been paid to agency questions within venture capital companies themselves and, hence, to discussing and debating *who,* in fact, is the venture capitalist in today's institutionalised forms of venture capitalism.

Have we missed a point when defining a venture capitalist?

We may even have missed the question of *who is a venture capitalist* in the first place. Taylor (1989) addresses this profound question in a column article describing how they historically were the *kings of countries* but are today the *kings of commerce;* parties who are interested in helping an established business with an acquisition or getting a new company off the ground. Taylor identifies 2,600 venture capitalists categorised into (i) investment partnerships and syndicates, (ii) public and private investment pools, (iii) investment banking venture funds, (iv) corporate venture companies, (v) small business investment companies, (vi) some state governments. Quite a diversity for *capitalists,* but yet so true. To pondering upon *why,* and *how,* any one of them *may be* or *may not be* interested in a particular investment, the golden rule applies: "He *who* has the gold, makes the rules."[25]

Most students of venture capital companies have approached the field from the SME perspective, primarily as financiers of such firms. Many have approached the industry from the corporate venturing perspective by studying venture capital as a strategic tool of corporate management. This study contributes to a new view by approaching the field from an *ownership*

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[25] The use of personal pronoun *he* should be understood (herein) as referring to *either or both sexes* (to serve practical *not* discriminatory purposes), unless used to refer to persons *specified* as either male or female.

perspective, first, by defining a venture capitalist as the *controlling owner* of a venture capital company, second, by emphasising the role of the venture capital company as an *owner (of investee firms)* and, third, by focusing research interest on the linkage between ownership and strategy in the venture capital company context. In their study on how venture capital firms differ, Elango, Fried, Hisrich, and Polonchek (1995) examine various factors as potential sources of difference between venture capital companies. From outside the scope of their study they end up proposing *overall goals* as one potentially differentiating factor; but *ownership* does not make the list. Regardless, they insightfully conclude their paper stating that "all venture capitalists are not created equal." It is appropriate to attribute early contributors Klaasen and Allen (1980: 13) who noted: "No single investment strategy or philosophy exists for either SBICs or venture capital companies. The industry's participants are simply too varied in size, administration, ownership, and origins." [26]

Venture capital organisations represent a concentration of significant economic *power* in today's world and, typically, control over the venture capital process is vested in the hands of extremely few individuals. The other side of the coin - often the much less addressed one - is *responsibility*. How power and responsibility are delegated; what are the sticks and carrots used, and how the process is controlled today vs. yesterday, in Europe vs. America; in the strategies they follow - are not widely addressed issues when defining the venture capitalist. In this sense, this study has been greatly stimulated by the directions by Brophy (1986) for future research on *intermediary* related questions regarding "the effects of different compensation systems on fund management, strategic planning and management of the core processes of a venture capital firm, and the interaction of the fund management with investors and entrepreneurs."

Although presently on the rise, research on agency related concerns has been scarce. As a result, conceptually speaking, both *venture capital companies* and *venture capital professionals* are referred to as venture capitalists. For this study, the definition of a venture capitalist is a key issue in understanding the object phenomenon. A venture capitalist is defined as the controlling owner of a venture capital company; not the company; and not the management (unless the company is management-owned). Thus, the venture capital company is approached as a vehicle of its owners. Owners establish the companies, set their missions and strategies, make the investment and divestment decisions, and control the operation. It is argued that the association between the ownership of the venture capital company and the identity of the venture capitalist has not been proposed before, and that the *owners* have - in some instances - become a somewhat neglected stakeholder of the venture capital process.

Investors providing the capital to be invested by venture capital companies have appeared more cautious in Europe than America with regard

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26 In the words of Roberts (1991): "Venture capital firms are as different from each other as are individuals."

to the aspects of management (control) of the venture capital process. Ultimate decision-making is often retained by the funders themselves, rather than truly delegated to the venture capital professionals. It is a firm standing of this dissertation that the true identity of the venture capitalist - the one who controls - is both a much-neglected issue and a central one to address in order to better understand the business or businesses within venture capitalism.

Is our picture incomplete as to how venture capital companies earn their living?

If we admit having missed a point when defining a venture capitalist, it is easier to admit uncertainty as to figuring out why venture capital companies exist. Are they all after similar transparent rewards? The underlying thesis of this dissertation is that owners make the difference as to why a venture capital company exists and how it earns a living. In other words, venture capitalist strategy logic does not necessarily derive all that directly from the *venture capital process*. Perhaps the venture capital process serves a different function to different type of players: A tool of economic *policy* to one, a tool of corporate *strategy* to another, and a direct source of *livelihood* only to the third?

Daems (1978: 66) makes a difference between visible and invisible concentration of corporate control. The former concerns legal structure and allocations of power which have dominated the focus of research to-date, whereas the latter is marked by interlocking directorships, holding companies, industrial combines, trusts, joint ventures, and cartel agreements as its "chief institutions." There are elements we can see and elements we cannot, also in venture capital, which we have yet to explore and disclose (see table 1).

TABLE 1 The visible and the invisible in venture capitalism

What we can see in venture capital include ('the tips of the iceberg'):
• successful/failed venture-backed companies and emerging new industries
• entrepreneurs happy/unhappy about their venture capital financiers
• flows of venture capital to different sectors and company development stages
What we cannot see include (constituting, in part, the 'Pandora's box'):
• what the venture capital firms *really* are after - what is the logic of their action
• who make the decisions; how are power and responsibility distributed within
• how does ownership relate to strategy (and economic impact of venture capital)

Besides disagreeing on how to identify the capitalists in venture capital, there have been extremely few organised attempts to study - in action in the field - what they actually pursue, why, and how. Does an investment in an investee venture have a similar importance and meaning in each venture capitalist's strategy logic? Are they all in the same business and, if so, what is the business? If, on the other hand, they are in different businesses, this should be reflected in stakeholder expectations. By understanding and accepting differences in venture capitalist strategy logic, the chances of success are increased when launching new venture capital operations, developing new industry stimulation schemes, and selecting venture capitalists either to make or to receive investments. As concluded by Amit, Brander, and Zott (1998): "In

seeking to understand venture capital finance, it therefore seems important to ask what exactly is the niche filled by venture capital firms."

Early contribution herein comes from Shames (1974) whose underlying thesis was "that each key player in venture management is, usually, inadequately aware of the aspirations, attitudes, goals, and problems of the other players." On his list of less well-known investment considerations of a venture capitalist, Shames (1974: 108-109) puts the question *"What is your business?"* on the top and shows (playing with examples such as "my business is carrying people from one place to another for the cost of a ticket" and "my business is steel making") how the answer not always communicates with the venture capitalist's world: *"The business of a company is making a maximum return on investment for its shareholders, including appropriate risk taking and changing with times. American Research and Development Corporation, a leading and the first publicly held venture capital firm says its business is, 'to help outstanding individuals build companies of stature and to create capital appreciation for the owners of these businesses and for the ARD shareholders'."*

In this study, the business of a venture capital company is not taken for granted. Distancing itself from the venture capital process based view, the study explores what the venture capital companies actually are after; and who their owners, financiers, suppliers, employees, customers, and competitors are.

Is there a need for new management tools in the venture capital industry?

> "The challenge we and other researchers face is to develop theoretical structures that can be subject to empirical investigation. Ideally such theories should also provide normative implications for practice." Amit, Brander, and Zott (1998).

Though valuable contributions have been made from various disciplines and research perspectives, there is still no comprehensive framework of the strategy world of the venture capital company. Thinking still largely follows the flow of the venture capital process, its individual stages, at the expense of pondering upon *what business purpose* the *whole* serves to different venture capitalists. The recent developments of venture capitalism have turned the hair grey of many a stakeholder trying to figure out what is happening to the business. In addition to changes in environment which make the operation of a venture capital company a more complex and difficult task, the scope of the industry has expanded - both in terms of investment criteria and the make-up of players.

Since the launch of this research project some thirteen years ago, the number of nations in transition to market economy has grown in Europe. With the increased number and variety of patients, there is an increased pressure on the doctor to perform. Simultaneously, with the increase of potential benefits from venture capital activity - emerging from privatisation in the East and integration in the West - the challenges of the industry have multiplied in complexity. In addition, the accelerating institutionalisation of venture capital (growth in number and size of funds managed by one venture capitalist), and the expanding scope of investments, have made their management, as well as the scholarly inquiry on their practice, an even more challenging job.

There is no theory on venture capitalism as a business phenomenon.[27] There is no theoretical framework that would both understand all forms of venture capital investing and offer a tool to analyse and improve the practice of the organisations involved. Creating a new strategy tool for the field of venture capital - a framework that helps understand the past, develop the present, and build the future in venture capital business - is easily concluded as the concrete key contribution sought for in this study. The new tool is aimed at helping venture capitalists in their strategy work, governments in policy making, investors and investees in their selection between venture capitalists, as well as our theory building around the phenomenon.

Can the developments observed in venture capitalism advance our theory of the firm?

The explosion of the size and scope of the venture capital industry during the observation period of this research project is an element of distraction and confusion to some scholars, while an additional source of motivation and stimulation to others. In less than two decades, venture capital has transformed from a uniform American cottage industry into a diverse, global phenomenon. Simultaneously, institutionalisation - growth in the size and number of funds under management for an average venture capital company - has vastly increased the economic significance of the industry. Consequently, as funds grow bigger, minimum investments also grow bigger. This seems to have permanently widened the investment spectrum of venture capital companies from the classic early stage ventures to large buyouts of more mature companies.

As pointed by Kierulff (1986: 148-149), a theory in any of the functional business disciplines - finance, accounting, marketing, management, business economics - is comprehensive only to the extent that it can explain and predict behaviour in extreme cases. "If the theory begins to collapse, researchers are then encouraged to develop new approaches to replace it." Echoing Brophy (1986), Kierulff urges that "work done in the functional fields of business and economics should be tested against the realities of the venture capital market."

In terms of economic significance, venture capital has, undoubtedly, been a high-growth phenomenon. Simultaneously, however, as the diversity of the field and the complexity of the business have increased, it has become neither less important nor more simplistic to approach and understand. In fact, an analysis of the field, from an ownership perspective, may yield deeper understanding of the newly emerging role of owners in corporate strategy reality.[28]

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[27] Bygrave's (1989) resource exchange model was the first comprehensive theoretical framework of the phenomenon, constructed (primarily) from the *macro* perspective.

[28] One of the leading companies of this diverse field, the American buyout-group *Kohlberg Kravis Roberts* (KKR), was around the beginning of this research project introduced to the public in the pages of *Barbarians at the gate* by Burrough and Helyer (1990). Before the project's completion, KKR was concluded to have served as *"the repair shop of capitalism"* in *The new financial capitalists* by Baker and Smith (1998: 204). Quite a 'volt' for one firm and, also, most eye-opening with regard to our perspectives on the phenomenon at hand.

Nature of the study

The kicker of this research project, in 1987, were observations of an unforeseen business phenomenon and the interest to make sense of it *inductively,* rather than hypotheses derived from existing theories to be tested deductively. The research process has geared around an empirically grounded, interdisciplinary, and exploratory approach where theorising is anchored to the venture capital context and the corporate strategy research domain.

The basic *inquiry paradigm* of the study, using the terminology of Guba and Lincoln (1995), is *constructivism.* Venture capitalist strategy logic is seen as a relativistic phenomenon, around which elements of hidden realities, hidden agendas, and individualistic logic of action are to be found. The methodological choices, and the role of data during the research, have followed the evolution of the researcher's industry career and the maturation process of his accumulating understanding of the business. The result is a holistic perspective on venture capitalism as a business phenomenon (see table 2).

TABLE 2 Demographics of the study summarised

Objectives of the study summarised:
1. Increase our understanding of venture capital as a business phenomenon
2. Redefine venture capitalists by studying *who* owns the venture capital firms
3. Investigate *why* venture capital firms exist; what do they do for their living
4. Examine *how* venture capitalists differ by strategy logic
5. Contribute to venture capital research in the corporate strategy context
Nature of the study in a nutshell:
• Inductive, exploratory, empirically grounded, interdisciplinary study
• *Theorising* anchored to venture capital and strategy research stemming from participant-conducted historical analyses, surveys, and case studies
Central research questions of the study:
• How are venture capital companies structured, owned, and organised, what are their product-market strategies, and how have these changed?
• How do ownership issues relate to strategy in the venture capital company context - can *archetypes* of venture capitalist strategy logic be depicted?

Earlier, venture capitalism was referred to as the Pandora's box of an integrating world economy; difficult to access, complicated to address, and time-consuming to investigate. As for the present study, *there was access before there was research,* the research was sparked off by *the insight that ownership is key to cracking the box,* and *time has been invested.* Inspired by the media, the key insight grew from the recognition that venture capitalism was inaugurated in America by wealthy *individual capitalists* whereas in Europe by widely-held *institutional entities* (see appendix 1 for evolution of the research topic).

The search for venture capitalist strategy logic, and archetypes thereof, is based on categorising venture capital companies by owner-type and attempts to discover their product-market thinking *within* the venture capital process context. Convinced that there is a logic, *someone's* logic, behind each implementation of strategy, emergence and evolution, venture capitalists are –

besides observed, surveyed, and interviewed - tracked back in history to gain understanding of what is essential therein, in order to set forth a *new* theory.

Strategy logic is explored to establish *similarities* to support a general conceptual framework of venture capitalist strategy logic (the new strategy tool); *differences* to establish archetypes that help establish realistic stakeholder expectations; and *them both* to contribute to our understanding of the linkages between ownership and strategy in the venture capital company context. In other words, as much as this dissertation seeks common denominators in order to propose general theory, it deals with what it is that distinguishes venture capitalists by strategy logic. The ambition is to better understand the diversity of venture capitalism as a business phenomenon.

The research topic has developed and matured throughout a lengthy, inductive research process and it has benefited from the simultaneous industry participation of the researcher. Hence, the final problem setting is a product of an intensive learning process and can be seen as a seminal research result in itself. Methodologically, the study uses four different approaches referred to as *conceptual constructing, historical review, survey exercise,* and *case study.* While they follow each other chronologically in the final reporting, in 'real life' they *built on one another*- as explained in further detail in chapter 2.2.

Limitations and concerns

Nature, background, and the setting of the study

This is an inductive exploratory study on venture capitalism, conducted, until year end 1996, by a full-time venture capital professional. While, undoubtedly, there are merits to such a participation-embedded research setting when examining a difficult-to-access phenomenon, there are also concerns for balance. For a long time, the research was exposed to a conflict of interest between *theory* and *practice*. The whole study had, in fact, taken off out of a *practitioner's interest* to improve himself as a venture capital professional.

On the other hand, the research has been free from this particular concern for over three years now. Besides, it is likely that without such personal access and participation of the researcher, none of the proposed leaps forward would have been possible. Furthermore, it would be far-reaching to expect *a researcher* to enter the grass-root level of a venture capital company and study the business from the inside as a full-time industry participant - in the 'trial and error fashion' - for a period of five to ten years.

> "We are subjective observers when we focus on change... We must be aware of our subjectivity and work to develop theory that explains patterns of actions, relationships, motivations, and outcomes. Only then can we help the managers, present and future, who will be working with their own sets of incomplete data to create the future in which we all will live." (Stevenson and Harmeling 1990.)

Venture capital defined broadly

In this study, venture capital is defined broadly. For example, buyout investing is included in the venture capital concept.

The use of *venture capital* as an umbrella term (covering also the later stage deals), may face opposition among certain authorities. In America, in particular, venture capital has been used to refer to the so-called classic investments, i.e., investments in entrepreneur-driven, early-stage, new-technology based ventures. During the early 1990s, there was somewhat of a heated debate ongoing in America on whether or not LBO investments should be included within the concept - even though the field has voted with its feet.[29] In Europe, such later-stage participations have dominated the investment spectrum of venture capital companies from the industry's beginning - not least because of differences in industry structures and the evolving integration that encourage divestments and growth by acquisitions. Recently, conceptual clarification has been pursued also in Europe, where *private equity* is increasingly referred to and used as the umbrella term - encouraging the use of *venture capital* in the (classic) early-stage context also in Europe.[30]

Nevertheless, this study sticks to venture capital as the umbrella term, but merely for the research-practical reason that it allows to use *venture capitalist*, respectively, as an umbrella concept for the actor within the phenomenon, instead of a 'neutral' *private equity investor*.

Perspective yet narrow – perhaps even narrow-minded

In this study, venture capital is approached from an untraditional perspective - that of the controlling owner of the venture capital company. To some, this may be a narrow-minded perspective; and yet *such venture capitalists* are sometimes difficult to identify from the bundle of principal-agent relationships in many of today's venture capital companies. While trying to maintain such focus - although the more traditional perspectives will be introduced in the report - aspects potentially crucial to students of the dominant approaches may be insufficiently emphasised, or even presented in a conflicting or unhoped-for light.

Entrepreneurs will become labelled *suppliers* and their firms referred to as the *raw material* of the venture capitalist. From the outset, this could be misinterpreted to belittle the role of entrepreneurs although the terminology is

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29 In the words of Fells (1989), past president of the Association of Canadian Venture Capital Companies: "We may question the value-added component of the LBO activity, but the fact remains that over half of the new capital coming into the venture capital industry in the last three years has been directed to the LBO field."

30 In 1998, the European Venture Capital Association (EVCA) changed its official name (not the abbreviation) into the *European Private Equity and Venture Capital Association*. In America, industry authorities have argued that buyouts (the kinds of investments that have historically been dominant for many EVCA members) do not belong to the sphere of *venture capital*. Says an EVCA authority (e-mail interview 1999): "We can consider [the name change], in a way, to encourage a more American definition of venture capital."

chosen merely to make a point. Investors in venture capitalists' fund vehicles will be called *funders* to make a distinction between a principal (owner) of a business and its capital provider (financier). The parties purchasing the venture capitalists' portfolio holdings will become labelled *consumers* not to undermine their professionalism but, rather, to underline their role as the ultimate *buyers* of the venture capitalist's products - normatively speaking.

Global contribution sought for by investigating only one (small) market in-depth

The scope of the study is global. Yet, empirically, only two markets are addressed: Finland, in which industry surveys are repeated and case studies conducted; and America, in which one industry survey and a general historical review are conducted. Hence, the results (including the archetypes of venture capitalist strategy logic), are exposed to concerns of generalisation.

Although the study is aimed at European-level contributions, it is conducted by one Finnish individual, rather than an international team, and it largely builds on empirical evidence from the Finnish market only. And although the research reports an interesting era in the Finnish economic and geopolitical development, Finland has been politically part of Europe (in the context of this study) only since 1995.

The study does not ponder upon the concept of risk

Venture capital is all about *risk* to many observers of the industry. This is particularly the case when approached as a *finance* phenomenon; one fulfilling a gap in the capital market. Barry (1994) concludes his introduction to the field as follows: "Thus, we have the opportunity and the necessity in venture capital to learn more about risk, uncertainty, and contracting technology." The present study does not oppose this view, since there may be aspects related to the *business concepts within* venture capitalism that will change our understanding of the role and nature of risk as it appears, in reality, to venture capitalists.[31]

Risk capital is a frequently used synonym for venture capital in everyday language. It is also common, in venture capital research, to study venture capitalists as *risk investors*, ones that accept the highest *investor risk* on the market. This is based on the argument that venture capital represents the widest risk-reward spread on the market; as if venture capitalists were the biggest speculators in the market. Although entrepreneurs will always have *one-case-specific* information not possessed by the venture capitalists, as noted by Barry (1994), the venture capitalists will, in turn, always have *related-case*

[31] March and Shapira (1988), in their study of managerial perspectives on risk, conclude with concern that when *calculation of expectations* is emphasised as a response to risk, decision-makers may become passive with respect to modifying the probabilities they face: "We may prefer to have managers imagine (sometimes falsely) that they can control their fates, rather than suffer the consequences of their imagining (sometimes falsely) that they cannot." In the view of the present study, the point is worthwhile not only to venture capitalists (deciding between entrepreneurs), but also to investors (deciding between venture capitalists).

information not possessed by entrepreneurs. In this study, venture capitalists are approached as *informed acquirers* and active owners of selected businesses – not as passive speculative investors (or financial gamblers).[32] Consequently, the concept of risk (as a quantifiable concept) is disregarded in this study as an *overrated* factor in the study of a venture capitalist's business.

This is not proposing that full advantage of disciplined procedures that far outperform 'the seat-of-the-pants methods of the past', should not be taken. Contributors to the concept of risk have "transformed the perception of risk from chance of loss into opportunity for gain, from fate and original design to sophisticated, probability-based forecasts of the future, and from helplessness to choice." (Bernstein 1996: 336-337.) If Bernstein is to be heard, perhaps the present study is not that far from an exploration of *risk*, after all; if we only accept that the concept can be approached and understood more as *choice*.[33]

In the view of this study, a clear distinction should be made between *informed* and *uninformed* acquirers of businesses, of kin to the difference between *active* and *passive* shareholders. It would be logical for these to go hand in hand; that informed acquirers be more active than the uninformed (or speculative) ones. Very seldom are industrial corporations thought of as taker's of the highest risk when they provide seed-stage funding for new ventures in their own core businesses within their own corporate structures. Equally seldom are individuals starting such companies as founding entrepreneurs thought of as such. In this study, venture capitalists are *informed* acquirers, of kin to industrial corporations and entrepreneurs, and not uninformed ones such as speculative purchasers of (public) stocks.

The motto of an informed acquirer could be for industrial corporations, entrepreneurs, and venture capitalists alike (borrowing a successful entrepreneur quoted by Stevenson and Sahlman 1986: 17): "My idea of risk and reward is for me to get the reward and others to take the risks."

The study does not measure performance

The study does not address the actual financial performance of venture capital companies. Obtaining comparable and reliable data on *the financial performance of venture capital companies* is extremely difficult (unless the company is publicly-held). It is least so on a single-investment basis. Bygrave and Stein (1989) measured the performance of 77 investments in companies that went public.

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[32] "Most entrepreneurs seek for start-up financing once in their lifetime; the venture capitalist is an old hand at dealing with prospective entrepreneurs. Most entrepreneurs are technical wizards with little experience in commercial negotiations and the world of finance; the venture capitalist is a savvy businessman. The entrepreneur has no reference point against which to determine whether he is getting a fair shake; the venture capitalist can compare a deal against many similar negotiations in the past." (Tyebjee and Bruno 1986.)

[33] In his exploration of risk, Bernstein (1996: 330) comes to conclude that "Bernoulli and Einstein were scientists concerned with the behaviour of the natural world, but human beings must contend with the behaviour of something beyond the patterns of nature, themselves. Indeed, as civilisation has pushed forward, nature's vagaries have mattered less and the decisions of people have mattered more."

Martin and Petty (1983) compared the performance of 11 American publicly-held venture capital companies to that of mutual funds and S&P 500 stock index; and Manigart, Joos, and De Vos (1992) analysed the overall performance of 33 publicly-held European venture capital companies in 1977-1991.

Regardless of the relevance of financial performance when evaluating venture capitalists, this study finds merit in addressing issues related to their missions and operational dynamism; whom each of them serves and what each of them is driven by. In the words inscribed on the cup of a 1984 senior hockey tournament in Canada (writer unknown):

> "For when the One Great Scorer comes to write against your name, he writes not that you won or lost, but how you played the game."

Within these limitations, the study aims at producing new insights on the *ownership* and *strategy world* of venture capitalists - who they are, where they come from, and where they seem to be going; what they pursue, how they operate, and why.

Structure of the report

The report is divided into seven chapters. The first two chapters introduce the perspective and objectives of the study, the research setting, and research strategy. In chapter 1.3, the contexts of venture capital, ownership, and strategy are discussed as an introduction to the conceptual framework of the study. Chapter 2 anchors the study methodologically and in terms of previous venture capital research, outlines the research design, and introduces aspects related to the empirical data. Chapters 3-6 report the results of the four different approaches employed.

In chapter 3, the conceptual framework of venture capitalist strategy logic is constructed. The *conceptual constructing* is largely based on theorising embedded in the researcher's own participation in the research phenomenon. The construction is based on looking at venture capital as a business phenomenon, as someone's business, simultaneously through three different lenses (ownership, strategy, and the venture capital process), and referring to the outlook as a *strategy logic* perspective. At the end of the chapter, the findings are incorporated into a general framework of venture capitalist strategy logic.

In chapter 4, a historical analysis on the evolution of the venture capitalist types (and strategy logic) is provided. Essentially, the birth and transformation of the diverse venture capitalist community, in America, is addressed in the chapter. By the end the chapter, a family tree of the venture capitalist is depicted. In chapter 5, archetypes of venture capitalist strategy logic are probed in a survey exercise. In this chapter, the results of the four industry surveys conducted in Finland and America in 1989-1997 are presented. In chapter 6, the archetypes are probed further in a single country case study

involving a follow-up of individual companies that have experienced changes of venture capitalist type.

Finally, in chapter 7, the results of the study are discussed, conclusions drawn, and proposals for further research constructed in the form of outlining an entirely new research direction. A Finnish summary of the thesis is provided on the final pages of the report.

1.3 Quest for *strategy logic*: The concepts of ownership and strategy in the venture capital company context

> In Silicon Valley, general partners (managing their fifth LP fund vehicle) decide on an equity investment in a prospective e-commerce venture and, in India, the investment committee of a multinational financial institution in a regional energy plant. In Russia, the board of an Italian corporate venturing unit decides to participate in the privatisation of a state-owned food processing facility and, in France, a British buyout group in that of a publicly-held diversified industrial conglomerate. At a local technology centre in Finland, the board of a local government-owned venture capital group agrees to provide equity backing for a biotech start-up and, in Germany, the private equity arm of a Dutch bank for an MBO deal in manufacturing.[34]

The above could be headlines, covering venture capital engagements, in the media today. As diverse a group as the parties to these engagements - investors *and* investees - have become, the *venture capital process* remains the common denominator. Regardless, as pointed out by Jennings and Sexton (1985), we should look *beyond* the process factors and ponder upon the *context* of venture capitalism, instead; and the implications to venture capital research.

This study works from the notion that the context of venture capitalism is *ownership* rather than finance. At the heart of the venture capital process, venture capital companies participate in investee governance more actively than public stock market investors - as *owners* versus *investors* - by insisting on shareholders' agreements and assuming active seats in boards of directors. The fact that, herein, venture capital companies are looked at as *owners* (rather than investors or financiers) of business firms and venture capitalists as the owners of the venture capital companies, makes venture capitalists *'owners of owners'*. Sometimes the owners of the owners have owners, too, which only makes the question the more intriguing: What do venture capital companies do for their living; do they *invest* for their living, do they *divest* for their living, or what is it that they do for a living?[35]

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34 Although far from an exclusive portrait, these *depicted cases* pursue to illustrate elements descriptive of the diversity prevailing in the industry today regarding the ownership and strategy of venture capital companies.

35 The quest here is of kin to Daems (1978: 37) who studied holding companies as "instruments for structuring and organising control over corporate decision making." In his view, the economic rationale for their existence must be sought in the "struggle for control over corporate wealth and corporate strategic decision-making."

In the light of this study, the venture capital engagements depicted above are merely the *visible* elements of strategy logic. Investment decisions do not necessarily have the same role and importance to each venture capital company. Looking at venture capitalism through the venture capital process window, *divestments* (rather than investments) and the *buyers of the portfolio stakes* (rather than the recipients of venture capital) should be at focus of discussion. But they are not. The discussion is focused on the entering stage. Getting money *inside companies* is, after all, the primary interest of entrepreneurs and government policy-makers. Even the investors of venture capital companies, who choose not to make direct investments, expect efficiency from the venture capital companies in putting their money to work. None of the stakeholders cares - primarily - how the venture capitalists earn their living; and whether they earn an excellent or poor living; as long as their own interests remain served.[36] This *does not* mean that venture capitalists are equally indifferent.

Who own the venture capital companies, why, and how; and what are venture capital companies engaged in producing, how, and to whom - are the central topics of this study - culminating in the questions of *ownership* and *strategy*. Next, the contexts of venture capital, ownership, and strategy will be introduced and discussed from the perspective of this study

Venture capital terminology defined for the study

Beauty, they say, is in the eye of the beholder. Venture capital, this study says, is in the eye of the *stakeholder*. Associated with qualities and expectations that make it the holy grail of the integrating world economy - the venture capital process is a target for strong aspirations by all of its stakeholders. This is visible in both theory (see chapter 2.1.1) and practice (see chapter 3.1.1). Venture capital is approached and defined as *financing* for entrepreneurial firms, as a *financial instrument* available for investors, as a *strategic tool* for corporate venturing, and as an *innovation financing system* worked around by national governments But it is also a *business* phenomenon; *someone's* business.

Classically, it could be said, venture capital refers to *temporary hands-on equity participations in novel-technology based entrepreneur-driven start-up ventures by (individual) capitalists*. Over time, variations have increased in *each* of the above aspects.

By definition, venture capital refers to *temporary* participation. Today, however, it can be as short-lived as a few months of bridge-financing. No longer is all venture capital participation *hands-on* in the classic sense of the word - time spent on the factory floors of portfolio companies. Less visible (and less appreciated) roles referred to as financial engineering have entered the picture. Fewer and fewer *equity-participations* are 'plain vanilla', straight

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[36] This should not be misunderstood. Often the profit split arrangements between investors and venture capitalists are such that the better the venture capitalist does, the better the investors will do and, hence, investors often have *an indirect interest* in that the venture capitalists earn a maximally good living.

common stock. More senior claims, such as convertible bonds and warrants with 'equity kickers', have come to dominate the instrument arsenal of venture capitalists. Besides *novel-technology based entrepreneur-driven start-up ventures,* the venture capitalists of today also operate in established corporations in mature businesses dealing with hired-management. And the *capitalists* themselves are vastly different from those of the early days. For quite some time, 'managerial revolution' has been in progress also in venture capital where complex contractual arrangements and institutional corporate structures have replaced individual capitalists investing on their own personal account.

Of all the changes discussed above, the fact that venture capitalists increasingly manoeuvre in mature businesses has caused the greatest confusion - even heated debates - as to what is happening to venture capitalism. In other words, the change of the *investment criteria* of venture capitalists has received the greatest attention to-date. This study openly belittles *this particular* change. In this study, any entity primarily engaged in the professional investment activity in which equity capital is pooled to be invested in active, temporary (roughly 1-10 year) ownership positions in private or to-be-privatised enterprises is referred to as a venture capital company.

While in literature, in general, venture capitalist typically refers to venture capital professionals regardless of whether or not they actually *control* the venture capital process, this study takes a different standing.[37] In this study, venture capital professionals are venture capitalists only if they are *the owners of control* of their venture capital company. Otherwise the venture capitalist is a *legal* person: A corporation or other institutional entity *represented* by natural persons (agents) as members of the board of directors. Also EVCA and KPMG (1997) link their definition of a venture capitalist to decision-making: A venture capital company either controls *or* advises, but a venture capitalist *controls*. In conclusion, the owners of venture capital companies *not* responsible for managing the capital are *not* referred to as venture capitalists. As concluded by the 1997 European Association of Securities Dealers (EASD) glossary of venture capital and IPO terms, a venture capitalist is either "an individual or entity that specialises in providing venture capital financing."[38]

The 1997 EVCA yearbook provides a number of definitions of venture capital terminology to which this study is anchored (see figure 3, emphases added).

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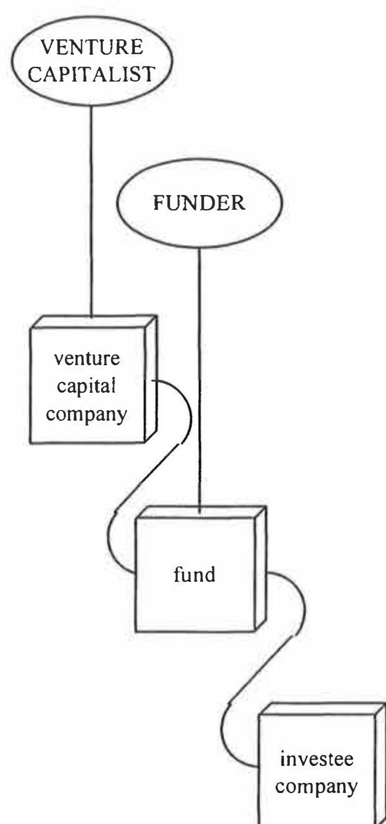
37 An analogy is what has happened to the concept of *entrepreneur*. The concept refers to both *owner-managers* of business firms and to *hired managers working in a entrepreneurial manner* in institutional settings (in business or administration), sometimes referred to as *intrapreneurs*.

38 Glossary published in 1997 by Brown Rudnick Freed & Gesmer (law firm based in Boston and London) in association with the EASD (an initiator of EASDAQ). Emphasis added.



Venture capitalist (venture capital manager):

A person or team *responsible for managing the investment capital* which has been supplied to the venture capital company by the funders.

Funder:

A *source of investment capital* for the venture capitalist. For captive venture capital companies, the funder(s) is (are) the parent organisation(s).

Venture capital company:

A corporate entity which *advises and/or is responsible for managing* the investment capital supplied to it by the funders. It undertakes or makes recommendations about the selection and monitoring of investments and the divestment process.

Fund:

A designated pool of investment capital which the venture capital company is responsible for advising and/or managing on behalf of the funder(s). Where a venture capital company does not make venture capital investments on behalf of its funder(s) via such discrete investment vehicles, the venture capital company should be regarded as only having one fund.

Portfolio company or investee company:

An organisation which is in receipt of venture capital from a fund advised or managed by a venture capital company

FIGURE 3 Key terms of the study defined (EVCA and KPMG 1997)

In summary, this study does not require firms to focus on early-stage or technology-driven investments in order to qualify as venture capital companies. Neither does the study require, nor control, that they are driven by classic direct-return principles. For example, entities concentrating on privatisation buyouts of under-performing publicly-listed corporations and economic-policy driven entities fully owned by national governments can both qualify as venture capital companies in this study, as long as they employ the venture capital process (compressible into four stages, i.e., fund-raising, entering, value-adding, and exiting).

Ownership of venture capital companies

In the early days, in America, venture capitalists were, by definition, natural persons. They were wealthy individuals, both self-made-men and heirs of (relatively) recently built fortunes. Even today, there are players like these on the market throughout the world, referred to as informal players or business angels. Regardless of how important they are and will be in so many ways to the fabric of venture capitalism - representing straightforward private missions

free of the agency related concerns pondered upon in this study - they fall outside its main scope. However, their role as fathers of venture capitalism will addressed in chapter 4.1.

Today's predominant professional forms of venture capital investing are manoeuvred from a variety of legal structures, in this study referred to as *venture capital companies*. Venture capital companies, composed of *management* and *funds*, bring together *venture capitalists* and their *funders* under specific contractual principles that derive from the chosen legal structures. Fundamentally, venture capital companies can be split into two structural categories depending upon whether or not they use separate legal entities as fund vehicles.

In the dominant structural category, limited-life limited-partnership (LP) fund-vehicles are utilised. Typically, in this category, the venture capitalists establish a venture capital company for the sole purpose of serving such funds as general partner. By its legal structure, the venture capital company is, today, most often a limited liability company. The venture capital company invites funders *for participation* as limited partners of the LP funds that are established for a *limited period of time*, typically ten years. This category is referred to as venture capitalists who utilise the LP fund structure.

In the other structural category, only one legal structure, typically a limited liability company, is established and utilised. The venture capitalists establish such an entity and invite funders to participate - for an *undefined period* of time - *alongside themselves as shareholders* in the venture capital company. Such a venture capital company is considered as having only one fund. This category is referred to as venture capitalists who utilise a single LTD structure. Every time such a venture capital firm engages in additional fund-raising, new shares are issued. Hence, by definition, every fund-raising exercise dilutes the venture capitalist's ownership position in the venture capital company, unless he himself participates in every issue, pro rata. In contrast, for a venture capitalist utilising the LP fund structure, new fund-raising efforts do not dilute ownership in the venture capital company.

In this study, the venture capitalist and the venture capital company are different persons. Whereas a venture capital company is always a *legal person*, the venture capitalist can be a team of *natural persons*. The venture capitalist, too, can be a legal person *represented* by natural persons and hence constituting, by definition, an interesting *dual personality* for the venture capitalist.

In summary, there is a profound difference in how the two structural categories function as ownership systems. In the former, a management-owned venture capital company could grow perpetually without any dilution of ownership, whereas in the latter, this is a limited window unless the management participates in every fund-raising (stock issue) or offers completely non-voting stock to their funders. Also in the former category, the agency relationship between the general partner and the limited partners of limited-life LP fund vehicles is of different nature than the relationship between a majority shareholder and a minority shareholder of a single LTD structure.

The ownership issue can be divided into 'who', 'why', and 'how' questions. 'Who' refers to the owners (natural vs. legal persons), 'why' refers to mission (financial/strategic), and 'how' refers to both the legal company structure and, importantly, the *width of the owner base.*

Strategy of venture capital companies

Often, the investment criteria of a venture capital company is referred to and studied as its strategy. In this study, strategy is addressed more comprehensively. The venture capital process is looked at *as a whole* and the role of the entering stage in a venture capitalist's strategy logic is not taken for granted. The strategy conception of this study is geared around understanding *strategy logic* (Näsi 1999) of the venture capitalist. An early strategy logic concept, the *business idea* approach (Normann 1976), depicts strategy as fit between three ingredients: organisation, product system, and market segments. This rationing is of close kin to how the venture capitalists themselves are reported to appraise investee candidates: Compressible (since Tyebjee and Bruno 1984 and MacMillan, Siegel, and Narasimha 1985) to management, product, and market.

Näsi, Laine, and Laine (1996) follow the idea of subjectivity in their definition for strategy logic. In the understanding of this study, a venture capitalist's strategy logic has become established to be (by and large) *subjective* logic.

> "We say that strategy logic of a firm comprehends a set of core elements in harmony of coordination, steering the whole of the firm towards survival and success. Strategy logic is subjective logic representing the thinking of key person(s) in the firm. Strategy logic may include both a metalogic thus showing the method and framework to create a strategy and a substance logic, now deciding what in the firm will be done. Strategy logic may be described in different ways from different sources: Straight from documents of the firm or in discussions with the key persons, or it can be an interpreted result of a case study, for example."

In this study the linkage between ownership and strategy is investigated in the venture capital company context. If strategy (and operational dynamism) is a product of ownership in venture capital, then perhaps changes in ownership could bring about desired changes in strategy (and hence dynamism) in venture capital activity - whenever it is considered necessary, for instance, to improve the efficiency of oversight of a market economy. Koski (1988: 4) offers insight from a corporate governance perspective.

> "Globally integrating financial markets and international ownership will inevitably influence the control and power relationships between corporate management and owners in terms of flexibility and freedom of corporate management's decision-making power. It is evident that corporate management must understand the potential effects of new ownership structures on business strategy development and implementation."

2 METHODOLOGY AND RESEARCH DESIGN

2.1 Research methodology

2.1.1 Directions in venture capital research

Prior research on venture capital has predominantly focused on a selected stage of the venture capital process rather than the whole. Given the increasing economic significance of the phenomenon, it has also been eagerly approached from several different disciplines by researchers with differing backgrounds, perspectives, and motivations. Venture capital is very much an environment-sensitive phenomenon folding into different forms in different times in different places. Respectively, every research conducted on the phenomenon is marked by its own era and the economy or market focused.

The *interdisciplinary* nature of this *high-growth* field of scholarly research is a constructive rather than a destructive force within the field (Fried and Hisrich 1988).[39] In this chapter, the different directions in venture capital research are discussed in an effort to depict the forest from the trees. The directions could be mapped in a multitude of ways; this study provides only one alternative. Rather than to provide a comprehensive literature review on any particular direction the aim herein is to open a fresh window on the diversity of research conducted on the subject phenomenon.

Establishing the venture capital process yardstick

In their seminal work - knitting together scattered previous research on the venture capital topic and working on a research methodology for the *burgeoning* field - Tyebjee and Bruno (1981) came to emphasise the management process of the venture capital company. Attributing Wells (1974), they introduced the

[39] Each individual study is like a *guided tour* into a popular *recreational forest*, different depending upon the guide, the season, the time of day, and the path being followed.

venture capital process divided in six stages: Deal search, screening, evaluation, venture board meetings and follow up, venture operations, and cashing out. Tyebjee and Bruno (1981: 282-283), acknowledging the *auspicious point in venture capital history* at which their research took place (following the 1978 liberation of ERISA ruling and the 1980 Investment Act), noted how the legislation "now permits venture capitalists *to raise money* from the public." However, *fund raising* did not, quite yet, make it as a stage of its own within the venture capital process, however (not before Tyebjee and Bruno 1984).[40]

Echoing Brophy (1986), the studies by Bygrave, Timmons, and Fast (1984) and Tyebjee and Bruno (1984) are the next landmarks of venture capital literature. The former study was the first to utilise a comprehensive data base suitable for venture capital research (one owned by Venture Economics, Inc) and thus opened an important avenue for "internally consistent, multifaceted studies of the venture capital process over time." The latter study achieved "important progress in the empirical analysis of the venture capital investment process."[41] Together, the two studies yielded, independently of each other, "rich insight on the factors and considerations involved in the venture capital investment process." Important parallel research (e.g., MacMillan, Siegel, and Narasimha 1985), helped anchor the field theoretically around the venture capital process. This also opened the possibility to establish venture capital as an independent research topic in research conferences which, in turn, eventually resulted in follow-on research by the leading teams involved (e.g., MacMillan and Narasimha 1987). Figure 4 depicts the venture capital process divided into four stages as it has become conceptualised in this study.

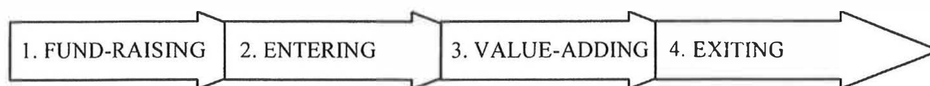


FIGURE 4 The stages of the venture capital process

The first weight point in venture capital research were studies focused on the *entering* stage analysing the criteria that venture capitalists use to make investment decisions, such as the seminal papers referred to above. Timmons, Muzyka, Stevenson, and Bygrave (1987) concluded that the identification of potentially successful ventures requires the consideration of a *constellation of factors* - that the individual criteria, in fact, merge into a *venture screen*. As another indication of the fruit of an increased attention on the phenomenon,

40 The conceptual inclusion of *fund raising* as the first stage of the venture capital process reflected a *factual* change in the nature of venture capitalism (funds have not always been raised to do venture capital investing). Around the same time the change was noted and the new stage included, the final stage of the process became renamed 'exiting' instead of 'cashing out'. This change, too, reflected a *factual* change; a change in venture capitalists' 'cashing out' logic: A point that will be elaborated, at length, in the course of this study.

41 One of the purposes of Tyebjee and Bruno (1984) was to stimulate an interest in modelling the management of venture capital funds. Their own conclusion that a "rigorously specified model... could not capture the heterogeneity of practices across many venture capital firms" left room for further *more descriptive* work.

Sandberg, Schweiger, and Hofer (1987) underlined the importance of studying decision *processes*, rather than merely decision *criteria* (which had been the focus of most of the previous studies) in search of the *venture capitalist's wisdom*.[42]

In terms of doctoral dissertations on the venture capital topic, 1989 was a prime vintage year. Bygrave (1989), Reiner (1989), and Sapienza (1989), each alone of significant contribution, together pushed the field a good leap forward. Thanks to their differing perspectives, approaches, and nature and type of data, the studies opened important new windows on understanding the venture capital phenomenon. Bygrave (1989) looked at the entire venture capital process both from a macro as well as micro perspective and created a theoretical model of understanding and approaching the venture capital activity: *The resource exchange model*. This study seeks to continue the way paved by Bygrave in constructing a theoretical framework – no longer from a general perspective but from the venture capitalist's specific perspective to understand the phenomenon as a business, rather than as a system.

Reiner (1989) dug deep into the roots of the activity, in America, and its transformation from a cottage industry towards the modern institutional forms. She reports an extensive investigation which is *yet to be discovered* by many; perhaps because the value of historical research has not yet really broken through in venture capital. Which, in turn, supports the thesis of this study that venture capital has not been thoroughly investigated as a *business phenomenon* (partly for reasons addressed herein, in chapter 2.1, partly for reasons addressed in chapter 3.1).

Sapienza (1989) examined the venture capitalist-entrepreneur relationship from different theoretical perspectives, one being related to the agency theory encouraging (among other things) the study of venture capitalists as agents of their investors. His work represents a culmination point in the shift of interest from *entering* to *value-adding* related questions. Some of the studies discussing whether or not venture capitalists really add value are reviewed in chapter 3.4.3. Sapienza (1989) succeeds to bridge the perspectives of entrepreneur and venture capitalist.

In summary, Bygrave provided the first comprehensive *theoretical framework of venture capital activity*, Reiner the *history of the venture capital organisations*, and Sapienza the *exposition of venture capital as interaction between individuals*. According to Bygrave (1989: 143) the key stakeholders of the venture capital process are (1) investors providing capital to venture capital firms (referred to as *funders* in this study), (2) general partners of venture capital firms investing capital in portfolio companies, and (3) entrepreneurs owning the portfolio companies in which venture capital is invested (see figure 5).

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[42] In their earlier paper, Sandberg and Hofer (1982) had suggested *venture capitalist's criteria as a source of wisdom* in determining the success of new ventures.

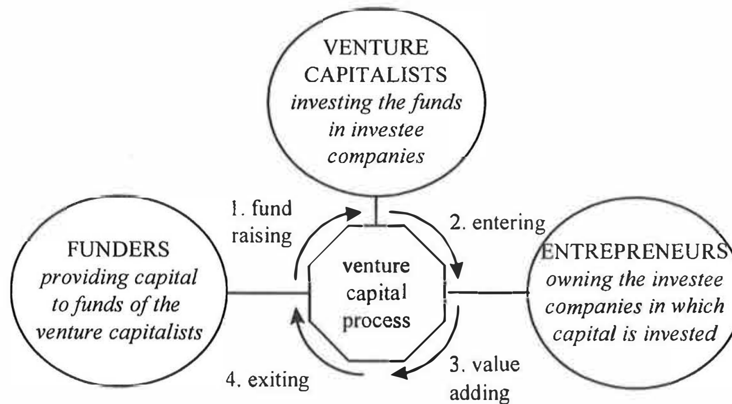

FIGURE 5 Stakeholders of the venture capital process

The window opened by Bygrave (1989) also helps to map the directions of past research on the venture capital phenomenon. Often, a given stakeholder group's point of view dominates a given venture capital study.

Stakeholder perspectives on venture capital

Venture capital investing has been economically, and hence politically, such a significant phenomenon that both academicians and practitioners have been attracted to studying the *stakeholder effects* of the industry rather than the livelihood logic of venture capitalists themselves. More interest has been paid on the function of the venture capital company to its stakeholders - the number of new jobs created in an economy, the rates of returns created for funders, and the hours spent with investee entrepreneurs - than on the function of the venture capital company to its owner, the venture capitalist.

Research on the venture capital company comprises a delicious argument for stakeholder extremists who postulate that a firm should be approached and understood as owned by a wider variety of stakeholders than shareholders alone. The owners of venture capital companies, too, have only been pleased to see their companies approached *also* as vehicles of their funders, investee entrepreneurs, and the economy at large; because this has increased government subsidies, funder participation, and entrepreneurial interest.

Most of the early research on venture capital was conducted from the *entrepreneurs'* point of view; largely in order to contribute to entrepreneurs' understanding of the investment criteria of the venture capitalists.[43] Then a large number of studies emerged from a *governmental* or general economic macro perspective to establish whether the impact of *venture capital finance* merits new or different fiscal incentives or other governmental forms of intervention. Much of this work has been funded by venture capital industry

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43 Khan (1987) addresses the entering stage from the venture capitalist's perspective. Amit, Brander, and Zott (1998) is a more recent example of the same.

associations. [44] More recently, research from the investors' perspective - looking at the performance of venture capital companies (either on individual investment or individual fund basis) - has been on the rise as a consequence of the increasing magnitude of venture capital as a *financial instrument*.[45]

In summary, venture capital companies can be viewed and studied as *creators of jobs* for an economy, *providers of financial instruments* for investors, *providers of finance* for entrepreneurial ventures (as they are in the dominant approaches to-date) or as *vehicles of their owners*, the venture capitalists, pursuing whatever missions *they* may desire, as is done in this study.[46]

Market (economy and culture) specific research

Research conducted on venture capital in Europe, a single market in making, is a good example of the relevance of this perspective. Europe comprises of several strong, historic nation states with differing local traditions, culture, and way of life. They all have different political backgrounds, economic histories, and business conceptions - as well as languages - also for venture capitalism.

Indeed, *languages* are key to understanding research conducted in different parts of Europe. Still in the 1980s, there were some profound conceptual differences in approach and terminology used to describe the juvenile phenomenon. And since people think and communicate via concepts and perceptions, these are not only semantic issues.[47] An important aspect with regard to the venture capital phenomenon is whether it is looked upon as an innovation financing system or as someone's business; whether it is envisioned as a machine to maintain or as people in action.

Venture capitalist serves as a good example of a culturally controversial concept.[48] In the Anglo-Saxon culture, and the English language, this is a natural, spirit-catching concept to use. It is widely used, too, in both literature and media, as well as spoken language. But listen to Finns, Germans, or Swedes discussing in their own language and you will *not* hear a direct translation used. The universal concept and word *capitalist* is, due to historic reasons, *less popular* in Europe than America. And, as for *venture*, there is practically none that works.[49] Consequently, many prefer reporting in English, a foreign language; as is also increasingly the trend in research in general. Nevertheless, labelling local players venture capitalists in research reports

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44 For a Canadian study on the impact of venture capital investing see Kostuch (1985).

45 An important stakeholder perspective and direction in venture capital research are studies conducted on the employment of the venture capital process as a corporate strategic tool. For early contributions on corporate venturing see, e.g., Vesper (1980), MacMillan (1986), Birley, Manning, and Norburn (1988).

46 Corporate venturing research, in which the venture capital firm is depicted as a *vehicle of corporate strategy*, is closely related with the approach entertained in the present study.

47 Particularly, as we will grow to learn, because venture capital business *is (operatively) largely comprised of* communication.

48 This also serves to explain the choice of *venture capital* as the umbrella term, *instead of private equity*, in this study.

49 Which, indirectly, may well explain the relative unpopularity of *capitalists* in Europe versus America.

written in English *does not* make them venture capitalists in the Anglo-Saxon association of the word. Sometimes a wrong impression of reality may be fostered due to terminology issues alone, other pitfalls being plenty.

Venture capitalism was imported to Finland under the *kehitysyhtiö* label in 1967.[50] To understand the association and dynamism related to this term it serves to go to year 1971, when *Kehitysaluerahasto Oy* was established. In Finnish, a developing country is *kehitysmaa* and a developing region *kehitysalue*. Hence, *Kehitysaluerahasto* is, directly translated, Fund for Developing Regions. Under this analogy, *kehitysyhtiö* is a *developing company* or, at best, a *company for developing companies*; an institution for poor businesses, rather than one for the best prospects. [51] In 1982, when the two first industry studies were published in Finland, there was only one private and a handful of public sector firms in operation. Rosenlew and Oravainen (1982) is a government commissioned report co-authored by a private venture capitalist (Rosenlew) and Virtanen (1982) a slightly more extensive study published by a government-owned venture capital firm and authored by an individual academician. Both reports were quite clearly written with missions to influence economic policy.

Virtanen (1982) is a good overview of industry experiences in different markets and an early Finnish account of industry wisdom. Interestingly however, the report manages to address the industry, including its launch in America, without even one referral to *venture capital* or *venture capitalist* (unless a reference made to *National Venture Capital Association* as a source of information is seen as such). Rosenlew and Oravainen (1982: 25) break the ice by mentioning venture capital companies and (vaguely) linking them with the *kehitysyhtiö* label.[52] Gylling (1985), president of a corporate venture capital firm, states clearly that *kehitysyhtiö* translates into *venture capital company* (the direct translation of which he labels *riskipääomayhtiö*).[53] Rosenlew (1985), a private venture capitalist, confirms the Finnish conceptualisation in an article in Swedish.[54]

Whereas in Finland far into the 1980s the player of the venture capital arena was referred to as *kehitysyhtiö* (as the local equivalent for a venture capitalist), a difference was made in Sweden between *utvecklingsbolag* (less profit-driven) and *venture capital bolag* (more profit-driven) already in 1983 (Affärsekonomi Management 2/1983, 1/1984, 7/1984). The direct phrase *venture capital* as well as *riskkapitalist* (risk capitalist) were readily used by Olofsson (Affärsvärlden 1983: 22/2, no. 8). Olofsson and Wahlbin (1985) distanced themselves further from the *utvecklingsbolag* concept: They refer to

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50 The direct translation of *kehitysyhtiö* into English is *development company*.

51 Kehitysaluerahasto Oy later changed its name into Kera Oy and, more recently, into Finnvera Oy.

52 "Euroopassa sijoitus- ja kehitysyhtiöitä on varsin vähän, sen sijaan USA:ssa niitä on useita satoja. Ns. Venture Capital -yritykset ovat erikoistuneet rahoittamaan... [pk-yrityksiä]".

53 "Kehitysyhtiöiden englanninkielinen nimi, Venture Capital Companies = riskipääoma-yhtiöt, kuvaakin parhaiten toiminnan perusluonteen."

54 "Utvecklingskapital - Venture Capital - betyder att utvecklingsbolaget tillskjuter något mer än enbart investeringmedel i portföljföretag" (Rosenlew 1985: 125) . In Swedish, *kehitysyhtiö* is *utvecklingsbolag*.

such as a distant segment by *excluding* them from the sphere of their study on *venture capital companies*.

Even Germany seemed to be ahead of Finland (*conceptually*) in 1983. Albach (1983: 997) presents that the typical American venture capital firm is organised by a private person, a *venture capitalist,* and underscores the importance of closely-held legal structures to their operative functioning.[55] For the record, also in Finland, Virtanen (1982: 167-168) had acknowledged that the ideal owners of a *kehitysyhtiö* are "private investors, businessmen, and corporations." Only the acceptance of his notion remained curtained behind a somewhat obscure label for some time.[56]

Industry reports by Sitra[57] (launched by Janatuinen 1987 and Mykkänen 1987) began to bring the conceptualisation to a modern level: *Venture capital,* the exact phrase, became properly introduced to the business community. Among the reports, a landmark book by Relander (1989) introduced the phrase *venture capitalist* to the Finnish vocabulary. In 1988, Sitra conducted their first industry survey - reportedly the first such empirical data gathering on the Finnish market.[58] The reports by Sitra served, early on, a practical demand, both local and international, and educated the Finnish stakeholders of the industry, in general, as well as the foreign stakeholders of the Finnish industry, in particular (some reports were also published in English, starting from Auer 1988).

Venture capital research from the 'more scholarly sphere' is still scarce in Finland. The first such studies comprise unpublished master's theses completed in the late 1980s[59], after which they have been plenty. Seppä (1989) is based on a relatively large survey data collected in 1988-1989 and is possibly the first academically reviewed empirical study. It also analysed the business of the *venture capitalist* in a historical comparison between America and Finland.[60] The first reviewed research papers presented in English for an international audience were those by Miettinen and Relander (1988), reporting experiences from individual investment cases, and Seppä and Näsi (1991), refining the raw material of Seppä (1989).

Venture capital was addressed in a doctoral dissertation first by Virtanen (1996) in a study from the entrepreneur's perspective titled: *Entrepreneurial finance and venture capital advantage.*[61] In his overview of past research on venture capital in Finland, Virtanen (1996: 12-15, 46) notes that earlier research largely comprises of either descriptive works or commissioned monographs by

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55 "Die typische amerikanische Venture Capital Company wird von einer Privatperson, einem Venture Capitalist, organisiert... Fur ihre Funktionsfähigkeit ist wichtig, dass es sich stets um eine *personnahe Rechtsform* handelt."

56 It is considered relevant to explain the conceptual foundation, in some detail, due to the background and early research history of this project, which are discussed in appendix 1.

57 Finnish National Fund for Research and Development (a governmental institution established in 1967).

58 Eventually, the research by Sitra transformed into a series of annual industry surveys.

59 First, at the University of Tampere, for example, by Ylikoivula (1987).

60 A direction followed also by Sitra's research (see, e.g., Auer 1990).

61 Virtanen (1979), a Ph.D. thesis on *acquisition planning as a process,* is an earlier 'related' contribution; introducing, independently of Wells (1974), close-to-identical stages built on by Tyebjee and Bruno (1981).

various institutions. Around the same time, Lumme, Mason, and Suomi (1996) published an academically reviewed paper on the returns of venture capital investing deriving from research on informal venture capital (or business angels) in Finland.

Border-crossing research

An important development in venture capital research has been the emergence of cross-market, comparative, often cross-Atlantic studies. Tyebjee and Vickery (1988) is a first to address the differences in venture capital activity in parts of Europe versus America. An integral role in the internationalisation of venture capital research and the increasing of awareness of the different markets has been played by the Annual Babson College Entrepreneurship Research Conferences that have offered a forum to present venture capital studies from different parts of the world.

Fried and Hisrich (1991) point out that there can be differences even between *regions* - of a given market - in industrial culture, and organisation and management orientation. Such were established between Silicon Valley and New England.[62] The landmark book of comprehensive global approach to the industry is *Venture Capital at the Crossroads* by Bygrave and Timmons (1992).

As referred to in the opening of this chapter, apart from borders between cultures or markets focused, one other important area where borders are being crossed has to do with the 'bookshelf' of the scholar: His discipline and tradition. Research on the venture capital phenomenon is, by definition, *interdisciplinary* as the field has not been strongly pressed towards a discipline of its own. Not many studies are markedly interdisciplinary in *themselves*, however; most often they are embedded in a major research discipline or domain - if not in entirely practical approaches applied by government policy makers, entrepreneur associations, and investor organisations.[63] An offspring of the venture capital literature are various *how-to guides* written to entrepreneurs on how to prepare a business plan.[64]

Quantitative versus qualitative approach

Most venture capital studies build on quantitative data; if empirical in the first place. There is a number of conceptual or discussion papers mainly by senior scholars, but empirical studies drawing from qualitative sets of data are strikingly scarce.[65] The three vintage year 1989 dissertations were impressive exceptions. Bygrave's (1989) exploratory and conceptual research derives from

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62 As an example of a cross-cultural approach, see Knight (1992).

63 Shames (1974: 111-113) provides the outline of an AMR International, Inc. *in-depth two-day seminar* on raising start-up or expansion capital from Spring 1970. This extensive list from 30 years ago is an insightful agenda to educate entrepreneurs on the venture capital topic. Still worth every applaud.

64 One of the first of the genre is by Haslett and Smollen (1983), originally published in 1972.

65 As examples of qualitative studies see Sandberg (1988) and Roberts (1991); as an example of a 'self-report', a case history written by a venture capitalist, see Pennington (1983).

both quantitative and qualitative sets of data. Sapienza digs (relatively) deeper qualitatively, but also employs a quantitative approach. Of the three, only Reiner relies entirely on qualitative data in her historical study.

Much of the research conducted in America is based on readily available quantitative data gathered on an annual basis by Venture Economics, Inc. and the major accounting companies in co-operation with industry associations such as NASBIC and NVCA. In Finland, as in the rest of Europe, similar research has been undertaken supported by FVCA and, on the European level, by the EVCA. For years already, the EVCA has been publishing an annual yearbook with an overview of each local market. The information provided therein has been increasing in terms of both width and depth, and the two trends can be expected to continue in the new millennium (see EVCA and KPMG 1993 and 1997).

Hisrich and Jankowicz (1990), who work on a *cognitive mapping method* for the study of *intuition* in venture capital decisions, is an example of an emerging trend in venture capital research which calls for more comprehensive, in-depth approaches to venture capital research (see, for instance, Fried and Hisrich 1991, Fried and Hisrich 1994, and Elango, Fried, Hisrich, and Polonchek 1995).

Classic venture capital versus leveraged buyouts

Since the late 1980s, a significant portion of time and money has been invested by venture capitalists in leveraged buyouts. This has not been reflected in venture capital research, however, by any other way than *conceptually* excluding such activities from the scope of research. In fact, in America, venture capital research has largely developed apart from buyout research. From a European perspective the two can be more easily merged - conceptually - and addressed as part of the same phenomenon. Interestingly enough, where classic venture capital research continues to focus on selected stages of the venture capital process (such as entering or value-adding), research focusing on leveraged buyouts takes a much more comprehensive perspective to the surrounding phenomenon (see Jensen 1989a).

Much of the previous research has focused on one slice of the phenomenon only rather than the whole.[66] The tips of the iceberg, or the small windows that such secluded aspects can open on the entire phenomenon, have helped see trees but not the (rapidly growing and diversifying) forest. Figure 6 seeks to illustrate the directions discovered in venture capital research in the course of this study, and choices available for the student.

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66 For example, on the *entering* stage of *classic venture capital* investing in the *American market* from the *investee's perspective* by a *finance* scholar employing a *quantitative approach* (methodologically); as illustrated by the underlined words and the grey 'spot' in figure 6.

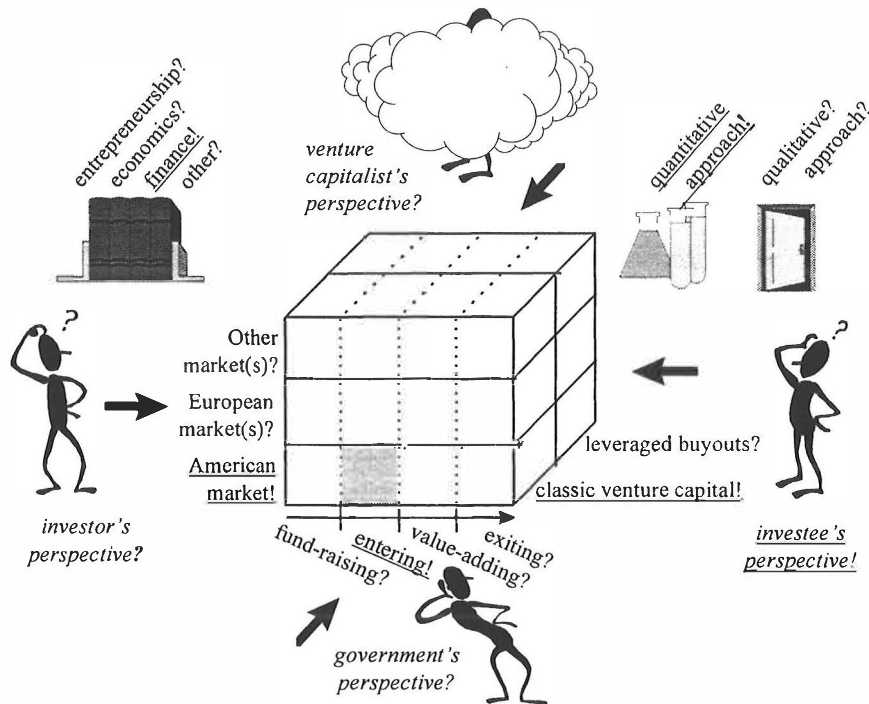

FIGURE 6 Directions of choice in the study of the venture capital phenomenon

> "The venture capital industry has reached a crossroads, and the direction it takes will have serious implications for its future. For practitioners, the roads lead to either opportunity or peril - opportunity for those who focus on value-adding and peril for those who bring only capital to venture capital deals. For policy-makers, the crossroads represent an opportunity to shape the environment for entrepreneurship and venture capital for the twenty-first century in a way that can go far to revive America's competitiveness. Academics also have choices to make and new avenues to explore in their research and teaching. As fields of formal study entrepreneurship and venture capital are in the adolescent stages; scholars have a chance to build solid intellectual foundations for both of them. The choices are there." (Bygrave and Timmons 1992: 323.)

2.1.2 Venture capital organisations as research objects

According to Robert (1988: 19), organisations are too often studied from a distance by outsiders looking for facts and examining the actions of a company years after they have happened, and with little or no contact with the executives of those firms. Venture capital companies are no exception and, if anything, to the worse.

Venture capital companies are traditionally difficult to access - not least for scholarly purposes seeking universal truth. Much due to access problems, as well as time constraints related to following full investment cycles of venture capital funds (often ten years or more), previous research has not extensively employed qualitative approaches. Instead, many of the studies focusing on venture capital companies have approached their objects as a set of given

numbers – derived from financial information or multiple choice questionnaires – crunched statistically for new scientific facts and theories, as was discussed in the previous chapter.

According to Fried and Hisrich (1994), traditional methodologies are not well-suited to an examination of the venture capital investment process, because the organisations involved are private. This is a view echoed by Amit, Brander, and Zott (1998), who find the venture capital industry difficult to study because not much relevant information is in the public domain, and because there is less regulatory scrutiny on the industry compared to other financial services, such as banking and insurance (see also Barry 1994).

Upon the dawn of the third millennium, venture capital companies represent a concentration of an ever-increasing significant economic power. Given the leanness of their organisations, vis-á-vis the amount of funds they control and the nature of the venture capital process, this is power vested in the hands of extremely few individuals. Such organisations are likely to remain difficult to access also in the future.

Sandberg (1988: 153), building on the attraction of strategic management research to understand the *real world,* calls for the use of *medium-grained methodologies* to develop contingency theories of new venture performance and *decision-making exercises* to sharpen our understanding of the criteria actually used by "the practitioners of an art that is intimately related to what we wish to study." His rationing is partly vested with the findings of Stahl and Zimmerer (1984), according to which acquisition decision-makers "did not demonstrate good insight" into their own decision criteria. A topic returned to, in the venture capital context, by Zacharakis and Meyer (1998).

Conducting an academic study on what presidents of nations *actually* do, let alone think, during their day – using the observation technique, let alone participation technique – would be a major access-related challenge. Respectively, it is difficult for an academic researcher to gain access to the *operation rooms* of the venture capitalists – their internal strategy sessions, road show presentations, deal negotiation tables, board meetings at investee firms, and closing discussions regarding exit arrangements. This, however, is venture capital.

Even if there is access, venture capitalists' action is difficult to interpret for several reasons:

- this is a private and secretive industry (no public records)
- strategising is done by just a few individuals (one has to access 'minds')
- the business concerns a long production process (ten years or more)

Often, venture capitalists grant researchers access to their business only after their most active professional years and – possibly – in the interest of having their memoirs registered and reported, perhaps somewhat goldened. The true logic of their invisible past operations and thinking, which a researcher desires to discover, is very hard to establish and control afterwards. Descriptively, a distinguished senior American venture capitalist, who had been involved with venture capital investing since 1950, started his panel

discussion (on the history of the venture capital industry) at a venture capital conference in 1990, as follows:

> "First of all, I want you to know, we must not take ourselves too seriously in all of this. We've been around a long time. Our memories get extremely convenient the longer the farther back it gets there. Fewer people remember what really happened. So we are able to tell you almost anything and you'll have very hard time checking on it." (1990 Venture Forum in San Francisco).

In summary, it can be concluded that a confidential access and years of time for a diligent observation will benefit a venture capital scholar's efforts to keep his investigation on a right track, conclusions relevant, and reporting truthful. To seriously address the linkage of ownership and strategy in the venture capital company context, one actually needs to go inside the venture capital companies and, in order to get some real answers, inside the heads of the people who run them. A participation-embedded approach could be well suited for the job.

2.1.3 Conducting research within the phenomenon explored

> "At the other end of the scale we invite scholars of general business history to connect their enquiries with the games that are currently going on in factories and firms. We certainly lack 'thick descriptions' of what Burawoy (1985) has called 'factory regimes', but often when we receive them, we have very few tools for understanding in detail the game between the actors involved, nor for telling whether what we anticipate as change or stability is indeed so. In our view, the patterning of interaction among micro-actors is only understandable through historic research, but business historians have seldom tried to connect their enquiries into the past with what goes on in factories and firms today" (Kristensen 1997: 42).

According to Zacharakis and Meyer (1998), past research, for instance on the decision criteria used by venture capitalists, can be biased and misleading, because it has relied on post hoc methodologies, such as surveys and interviews. Such approaches are based on the assumption that venture capitalists can accurately relate their own decision process, while "studies from cognitive psychology suggest that people, experts in particular, are poor at introspecting." They use social judgement theory, and an associated lens model as their framework, and policy-capturing, a real-time method of cognitive psychology, to capture venture capitalists' *actual theories in use* versus *espoused theories*. The drawback of the *paper test* approach, is that venture capitalists participate in a decision situation that does not perfectly mirror the *real-life* decision.

It was argued in the previous chapter that while venture capital research could significantly benefit from participatory research approaches, such are very difficult to apply to this phenomenon due to access and time related concerns. This study has, however, enjoyed both *access* and *time*; and can hence be argued as built on an ideal foundation. On the flip side, predominantly practical aspirations were long the main drivers of the investigation. This,

naturally, raises a concern of scholarly bias and the issue of built-in subjectivity.[67]

The subjectivity of the researcher is a much debated issue. While some insist on strictly controlling the objectivity of research, others argue that there can be no such thing - least so when applying in-depth methods, interviews and observation techniques. The data is always there for the performing scholar alone to interpret. Again, beauty seems to be in the eye of the beholder. Nevertheless, this study takes the issue of potential bias not lightly at all. Several control efforts are made to probe the soundness of the researcher's interpretations. Besides industry surveys and case studies conducted to probe the insights and viewpoints derived during the years of industry participation, the past three years off the field have perhaps served as the most efficient control mechanism.

According to Barry (1994), the field is "ripe for new research." He calls for both theoretical and empirical studies and concludes: "Such studies will not be easy to complete, but they can make an important contribution to our knowledge about venture capital. The risks are high, but the potential rewards are enticing."

2.2 Research strategy: A synthesis of four methodological approaches

> "If we are so tame as to only report that which can be proved beyond a shadow of a referee's doubt, it is unlikely that we will be of significant help to those managers who are leading the way. At best we will be documenting history, without meeting the test of deep understanding of when, how, and why." (Stevenson and Harmeling 1990.)

In this study, research questions have driven the methodological choices, rather than the other way around.

This research dives underneath the skin of venture capitalism ambitiously aimed at cracking what has become referred to as Pandora's box. The study was launched with the broad mission of *making sense of a newly discovered Finnish business phenomenon* but became, eventually (as elaborated in greater detail in appendix 1), aimed at understanding *venture capitalism as a global phenomenon* by exploring venture capitalists and their business from the inside - based on the scholar's personal participation in the phenomenon. This grew to be a predominantly *conceptual, interdisciplinary study* based on inductive, exploratory empirically embedded investigation deriving from a diverse set of data. Such a holistic set-up, originally based on an *ad hoc* inductive approach -

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[67] The origin of the study is no *chicken and the egg* problem. One year before the study was launched, the researcher had entered an apprenticeship programme at a private Finnish venture capital group, and served the industry until year-end 1996. He has been completely free of industry ties for over three years now.

ambitious for a venture capital study but challenging for a scholarly apprentice work – enjoys encouragement by Mintzberg (1973).

> "Students of research methodology in social sciences generally agree that at early stages in the study of a phenomenon, there is a need to use less rigorous, more exploratory approaches, that can encompass more variables. Only by remaining open to the rich complexity of reality can effective theory building be initiated in a new field. This applies especially to phenomena that involve the close interrelationships of many variables, most of which are difficult to measure. Thus Management Policy research will bear the most fruit when it is inductive, since the need is to build new theories; when it is creative, since the need is for significant conceptual leaps forward; and when it is focused in the field, where the richness of complexity is to be found."

Jamison (1981) encourages to utilise the individual perspectives of *industrial organisation*, *marketing*, and *administrative behaviour* to build "complex tools" for strategic management research. In his view such integrative approaches can contribute to our understanding of strategy content issues as well as strategy process issues. This study can be seen as an attempt to follow the advice.

Snow and Miles (1983: 253-255) encourage the development of "appropriate typologies of key environmental, organisational, and individual/group characteristics," while such serve to synthesise present knowledge plus provides "a means for generating new knowledge about organisations and management." They question, however, is whether typologies can be constructed for use "in each of the three key overlays of industry, strategy, and management philosophy." They feel comfortable with the latter two. With regard to industry typology, they conclude, it could be "that more than one industry typology – and therefore perhaps more than one industry overlay – may be required." To Snow and Miles (1983), "even a rudimentary general framework, employing no more than the three overlays described here, provides a very powerful diagnostic tool."

Herein, the cracking of the 'box' is based on four methodologically different approaches referred to as *conceptual constructing, historical review, survey exercise,* and *case study*. These are not separate research stages (conducted chronologically one after another) but, rather, *interacting* efforts or tools *used simultaneously* to reach the defined goal. There were large variations in intensity between each of the research efforts during the entire process. Conceptual constructing took place from day one of the project until the final printing of the report. Also the data for each research effort was collected throughout the project, with certain (more than natural) exceptions. For example, data for the survey exercise was collected only from time to time, for instance when the questionnaires were mailed. With regard to the case study, although relevant material was constantly screened in the media, interviews took place and company material was received only at given points in time. Table 3 provides an advance summary of the key empirical research questions addressed during each approach.

TABLE 3 Key empirical research questions summarised

1. CONCEPTUAL CONSTRUCTING: • Who is a *venture capitalist* and what is his *business*? • How are venture capitalists *organised*, what do they *produce* and *sell*, and *to whom*? • Is there a *traceable logic to venture capitalist strategy* and, if so, can it be *framed?* • How do all these questions relate to the existence of *venture capital companies*?
2. HISTORICAL REVIEW: • How has *ownership* of venture capital companies *developed in America*, and what has happened to *strategy* during the transformation process? • Can *general archetypes* of venture capitalist strategy logic be depicted? • How was venture capitalism *imported to Europe*, particularly Finland, and how has *strategy logic* developed in this market over time?
3. SURVEY EXERCISE: • Is there support for the general construction of the proposed framework of venture capitalist strategy logic and typology thereof? • Can material differences in the strategy of venture capital companies be *explained* by their material differences in ownership?
4. CASE STUDY: • Does the change of venture capitalist type affect strategy logic, i.e., is a material change in a venture capital company's ownership reflected in its way to operate and its product-market conception?

Final *conclusions* on each research were pursued in a *relatively* chronological order. Conclusions from the survey exercise were not pursued before those from the historical review were concluded. Neither were such pursued from the case study prior to drawing conclusions from the survey exercise. Whereas the different research approaches may have interacted with each other at first in a less than organised manner, they all came together, towards the end in a most harmonious way.

The starting point of the study was the researcher's access to the phenomenon, as an executive inside a venture capital company and, in such a role, outside in the field in numerous interactive situations with representatives of various stakeholders: Entrepreneurs, investors, other venture capitalists, and government. Much of the bottom line is hence derived from insights from the researcher's personal experiences – as these have matured over the lengthy research period (over one third of the researcher's lifetime so far).

The following figure illustrates the research strategy in a way which is also descriptive to the reporting.

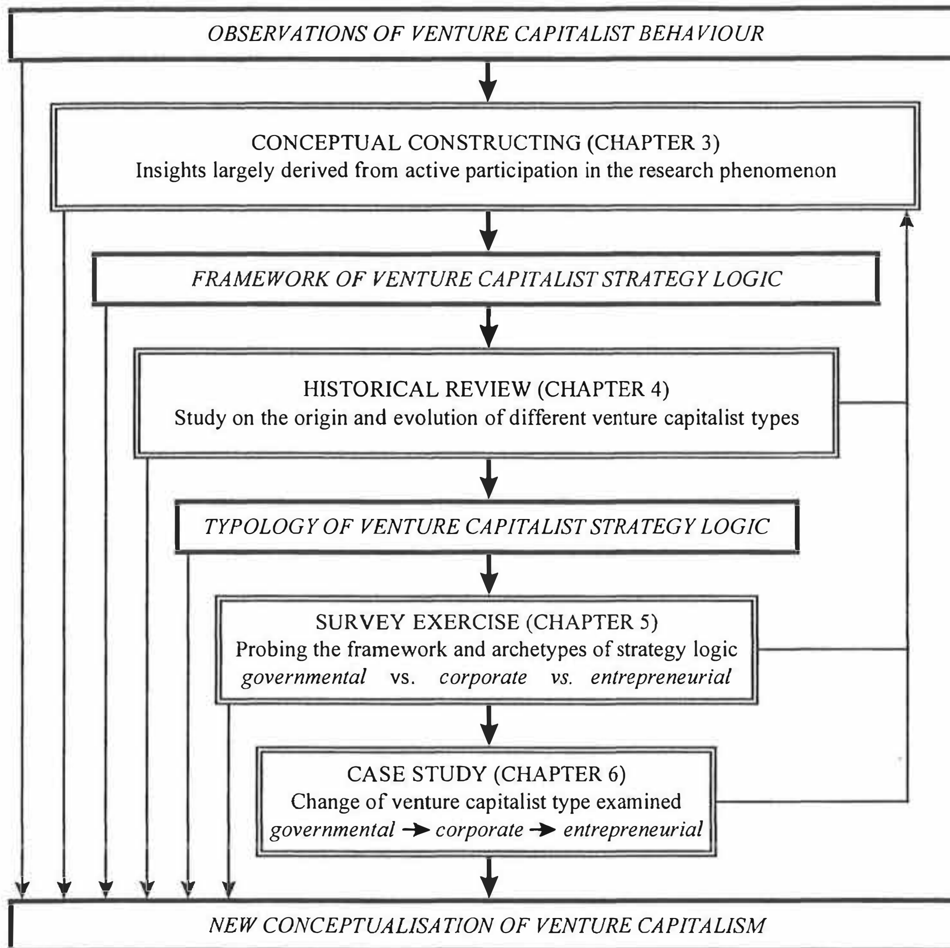

FIGURE 7 Research strategy illustrated (a report disposition perspective)

2.2.1 *Conceptual constructing* to reframe the phenomenon

> "How do we know the dancer from the dance? When we view entrepreneurship from a behavioural perspective we do not artificially separate dancer from dance, we do not attempt to fashion a reassuring simplicity. The behavioural approach challenges us to develop research questions, methodologies and techniques that will do justice to the complexity of entrepreneurship." (Gartner 1989.)

The study pursues to refine the definition of a venture capitalist by examining the ownership of venture capital companies. Furthermore, building on notions or concepts of *separation of ownership from control*, *managerial revolution*, *shareholder activism*, and *corporate governance*, the study seeks early contributions towards a new conceptualisation for the entire wave of actors of the *venture capitalist kind*. What differentiates this from most conceptual studies, however, is that it is not a pure 'desk study', a mere synthesis of existing literature. The key insights towards the new conceptualisation on venture capitalism offered in

the study are not only embedded in theory but, more importantly, in practice – in participation-embedded observations made in a real life laboratory. This, in turn, underlines the inductive nature of the study.

The mission of this study was, at first, based on participation as a *hired manager*, to determine what the business of the venture capitalist is, by studying *what* they do. The objective was to *describe what* happens. As the opportunity presented itself, the strategy was extended to include participation as a *venture capitalist*. By so doing the crossbar became raised towards *understanding why* they do what they do.

Early on, there was the insight of how to identify a venture capitalist and how to differentiate between the different types, how to study what their business is and what the differences are. The concepts described in this study are, hence, largely reflections of the thought process of *a venture capitalist* as lived through personally by the researcher during a maturation process from a novice to more of an expert (if not always consciously, at least intuitively and, admittedly, at times in quite an unstructured manner).

The study pursues to extract out of the minds of the people who run the business their actual thoughts on what the business is and how they go about positioning their company competitively in its environment in lieu of *qualitative* parameters (opinions, judgements, feelings), rather than merely quantitative ones (such as financial figures on the company, the industry, and the economy). By way of *conceptual constructing*, the observations are melted into a new framework, ideally of tool value in understanding and managing of the venture capital business.

This research was triggered by personal observations of a powerful, new phenomenon in an economy – a devotion to make sense of an exciting, yet puzzling new business, rather than test hypotheses derived from existing theories. A passion to improve the tools of managing such business, what ever it takes, and a sincere desire to advance science on the side, have fuelled the research ever since its launch. Such a foundation underlines the pursuit to produce new knowledge in the form of deeper understanding of a particular, newly conceptualised phenomenon. The research setting finds support also in the grounded-theory approach set forth by Glaser and Strauss (1967); the application of which is justified when research is focused on a phenomenon of which there is little theoretical knowledge and which is still conceptually vague.

This study brings together two large and quite different fields of research: venture capital and strategy – the former being the substance area and the latter the source of research tools used in the investigation. Both fields are, more or less, interdisciplinary. Venture capital is a merger of entries from a wide variety of disciplines, dominated by those from economics, entrepreneurship, and finance. While the research object presents a platform that is conceptually both complex and disputed, the study has looked for theoretical tools that are the opposite. Empirically, the quest for strategy logic is tied to exploring linkages between ownership and strategy of venture capital companies as a function of time and place in America and Europe.

The selected approach anchors the empirical research interest in studying the forms of organisation structures - management, corporate, and governance structures - the products or services offered and the markets or customers served by the various venture capital companies - and the fit, or the lack of fit, thereof. In the capacity of the chosen theoretical tools, the study pursues to describe the strategic processes of a venture capital company, the various forms of organisation, and the prevailing product-market preferences under each dominant type - all as functions of time and place, i.e., as functions of geographic or cultural/geopolitical location and the development status of the central economic institutions such as the size and efficiency of the capital market and the markets for goods, services, and labour.

Methodologically, the subject phenomenon is approached, from one hand, inductively from inside the phenomenon and, from the other hand, based on a multitude of methods ranging from historical analyses to industry surveys and case studies. In the theory building, a comprehensive approach to venture capital as a business of the venture capitalist is presented.[68] The key research questions of *conceptual constructing* can be compressed as follows:

- Who is a *venture capitalist* and what is his *business*?
- How are they *organised*, what do they *produce* and *sell*, and *to whom*?
- Is there a *traceable logic to venture capitalist strategy* and, if so, can it be *framed?*
- How do all these questions relate to the existence of *venture capital companies*?

2.2.2 *Historical review* on the evolution of venture capitalist types

The historical review builds on the specific conceptual foundation for venture capitalism constructed in the study. In other words, history of venture capital companies was studied with measures and variables established during the research process. The construction and refining of the variables took place throughout the research process and *in interaction* between the different research approaches. The findings are naturally reported as drafted after the new conceptualisation had become entirely completed.

From the very beginning of the research project, since 1987, the study has taken an interest in the origin of venture capitalism - the players and the game. At one point, this was supposed to be a *history of venture capitalism* or a description of its transformation process (which it still is, to an extent). Aimed at serving European concerns regarding allocation and nature of venture capital investing within Europe, versus America, it has been deemed important to study the evolution of the venture capitalist types and their strategy logic on both sides of the Atlantic.

The historical review largely derives from *under-utilised* sources, such as testimonies by individuals who themselves have participated in the

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68 Physically, this research was conducted in Finland, on a part-time basis, until summer 1990, after which in America, on a full-time basis, for a period of 15 months. During 1991-1996, the researcher worked full-time in venture capital, engaged mainly in *entering* and *value-adding* in the FSU market and in *fund-raising* in America and Europe. During 1997-2000, the researcher has been able to concentrate on the completion of the study.

phenomenon and by journalists or contemporary authors who have followed venture capitalists in their work (e.g., Bylinsky 1976, Shames 1974, Silver 1985, Davis 1986, Wilson 1986). Also, among such sources, are various studies by more academically motivated scholars (e.g., Dominguez 1974, Klaasen and Allen 1980, and Reiner 1989).

Another important source has been the venture capital conferences attended by the researcher during the research project, particularly the panel discussion which opened the 1990 Venture Forum in San Francisco titled: *Venture capital, the four first decades: Laying a foundation for the future* (see appendix 2 for the full list of conferences attended). The key research questions of the historical analysis can be summarised as follows:

- How has *ownership* of venture capital companies *developed in America,* and what has happened to *strategy* during the transformation process?
- Can *general archetypes* of venture capitalist strategy logic be depicted?
- How was venture capitalism *imported to Europe,* particularly Finland, and how has *strategy logic* developed on this market over time?

2.2.3 *Survey exercise* to probe the linkage of ownership and strategy

The framework of venture capitalist strategy logic, sketched during the first years of the research process, has served as the lighthouse of the survey exercise. With the exception of the first survey, which was based on a very initial understanding of the phenomenon in 1988-1989, the survey exercise took place after the central ingredients of the strategy logic framework had been discovered. On the same token it is to be noted that the framework received its final shape only after the last survey in 1997. This illustrates, in part, how the separate research approaches have interacted during the process and how its inductive and exploratory nature have shown during the process.

The surveys, conducted in Finland in 1989, in Finland and America in 1992, and in Finland in 1997, comprise an important cornerstone of the empirical data of the study (copies of the questionnaires are to be found as appendices 3-5). Regardless of the fact that none of the surveys were planned to be repeated, the three surveys conducted in Finland still constitute for longitudinal data on the development of the industry in the country. The survey conducted in America, in 1992, provides an interesting benchmark towards which the Finnish field can be reviewed and contrasted over time. The survey exercise (each survey) is introduced in more detail in chapter 5.1.

The data provided by the surveys is mainly used to probe the typology of strategy logic. Results of the survey exercise are provided in chapter 5. In a nutshell, the survey exercise seeks to answer the following questions:

- Is there support for the general construction of the proposed framework of venture capitalist strategy logic and typology thereof?
- Can material differences in strategy of venture capital companies be *explained* by their material differences in ownership?

2.2.4 *Case study* to address strategy logic through times of change

The study focuses on Finland as its case economy (or market) and, given its global reach and ambition, could be labelled *a single country case study*. There are two company cases *within* and a general historical analysis of the industry formation which largely derives from Seppä (1989).

Selecting a case company for an academic research on an *availability basis* must be more the rule than the exception. This, at least, must be reality in venture capital research. The companies are difficult to access for a multitude of reasons. Realistically, why would a private enterprise open its doors to investigators unless it can control the process, is at ease with the researcher, *and* can expect to benefit from it. With regard to Finland, an additional challenge is the limited number of venture capital companies and, moreover, the young age of most of them. Notably, many of the local pioneers of the field have ceased to exist long ago. This limits the number of *relevant* targets even further. Since the main objective of the case study *herein* was to study the effects of *change of owner type* on the strategy of the venture capital company, a crucial selection criteria was that the case company had experienced such a change. This requirement narrowed the pool of candidates *even further*.

In short, this study is proud of the co-operation of *Sponsor Capital Oy* (previously Sponsor Oy), the leader of the *kehitysyhtiö* era (1967-1989) and a major force still today, and *CapMan Capital Management Oy*, the leader and the flagship of the industry's second coming (since 1989), as the cases *within*.

Sponsor Oy was established in 1967, majority owned by the Bank of Finland. It was the industry pioneer, and the local prototype of a single LTD structure. In 1983, the Bank of Finland released its majority ownership and soon thereafter Sponsor became listed in the Helsinki stock exchange. By 1989, after an extensive growth of capitalisation, Sponsor ended up fully owned by Kansallis-Osake-Pankki (KOP), one of two leading commercial banking groups that today are part of MeritaNordbanken. In 1997, following a creative MBO-procedure, Sponsor became restructured and converted to utilise the LP fund structure, a *new* LP fund with ca. $100 million in total capitalisation, managed by a *new* management-owned venture capital company, Sponsor Capital Oy.

CapMan Capital Management Oy was established in 1988, owned 40% by KOP and 40% by Insurance Company Pohjola Ltd (the cornerstones of the leading financial grouping in Finland), and 20% by a Swedish consultancy, Cap Programator Ab. In 1989, CapMan raised the first limited-life LP fund vehicle in Finland (involving *non-owners* as funders) closed at ca. $11 million. In a 1993 MBO, the management of CapMan turned the company into Finland's first partner-driven venture capital company utilising the LP fund structure. Today, CapMan is clearly the market leader in Finland, as well as a renown player on the European level. It is engaged in the management of ten different fund vehicles and has ca. $660 million of total funds under management.

Information on the case companies was collected primarily via personal interviews with key individuals (past and present) of the two companies. Altogether nine recorded interviews were conducted in 1993, 1997, and 2000.

All interviews were conducted in single sessions, typically lasting 45-60 minutes. The interviews were guided by an interview outline and, for the first interviews with each individual, an advance copy of the outline was sent (see appendix 7). The purpose of the case study is to address the following question:

- Does a change of venture capitalist type affect strategy logic, i.e., is a material change in a venture capital company's ownership reflected in its way to operate and its product-market conception?

2.3 Nature and role of empirical data under each approach

This research can be seen to be composed of four different studies; not chronological but studies that build upon one another. The study took off in a highly inductive spirit, ignited by observations of a new business phenomenon and a determination to make sense of what it was all about – working *inside* the phenomenon. Figure 8 pursues to knit together and summarise the key aspects related to the collection of empirical data during the different research stages.

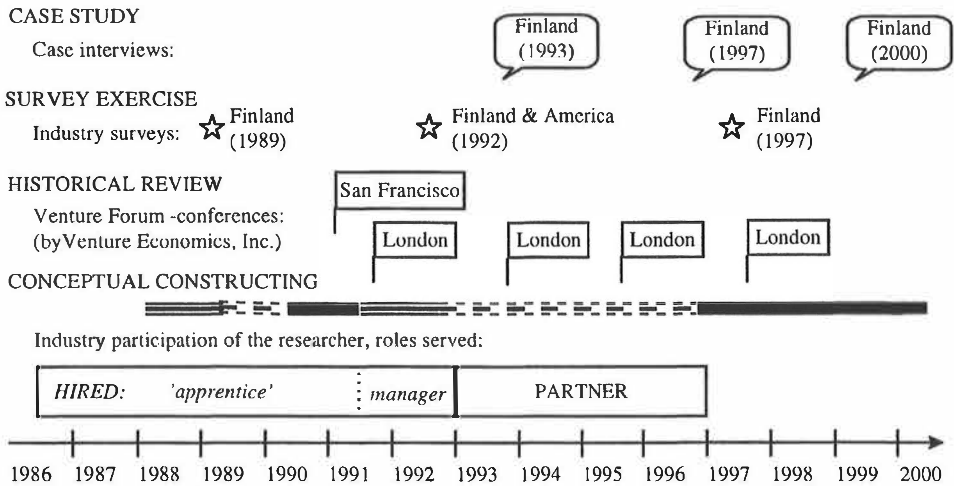

FIGURE 8 Stages and main events of data collection over time

Early on the study grew *conceptual* by nature aimed to reframe the phenomenon based on a synthesis of different approaches and interdisciplinary theorising. In order to understand more fully the origin and evolution of the phenomenon, a historical approach emerged. Largely to probe and refine the framework as a management tool for the venture capital business, partly to confirm the results of the historical review, the survey exercise was extended towards longitudinal value. Last, but not least, a case study was conducted to further probe the linkages and to confirm and illustrate the practicality of the management tool.

The nature and role of empirical data varied across the different research periods. And so did selection, collection, and analysis of data. Next, the four approaches are summarised, in table 4, in order to give a more complete picture of the 'empirical making' of this research. Again, it needs to be highlighted that - in real life - they did not follow each other all that chronologically, but rather intermingling with each other. In retrospect, however, this is the order in which the different approaches were perceived to have emerged into each of their periodical key role during the research process. The following figure presents the main events of data collection as a function of time.

TABLE 4 Nature and role of empirical data - and the selection, collection, and analysis thereof - during the different research stages

Research approach:	Nature of empirical data	Role of empirical data	Selection of empirical data	Collection of empirical data	Analysis of empirical data
Conceptual constructing	observations of venture capitalist behaviour (partly participation-embedded), memoranda and reports by industry professionals	help formulate a new conceptualisation of venture capitalism in a framework based on an insider's understanding of the phenomenon	researcher's employers in 1986-1996; key professional journals, books, industry seminars in America and Europe	observations working within venture capital firms in interaction with stake-holders, partly directly from the mind of a participant	synthesis of the empirical observations, field reports, and the guiding theoretical frame related notions merged into a framework
Historical review	rich variety of written material on venture capitalism, from practical contemporary views to more systematic observations	deepen the understanding of the origin and evolution of the different venture capitalist types and their basic strategy logic	previous literature, seminars, and background analyses, media reports on the developments of the markets addressed	systematic generation of data from industry firms, associations, seminars, literature and contemporary media	review of the documents and utilisation of the survey data in accordance with the conceptual framework
Survey exercise	questionnaires filled in by presidents (or persons assigned by presidents) of venture capital companies in Finland and America	help probe the conceptual framework, and the archetypes of strategy logic by providing statistical evidence on the linkages	all companies active in venture capital in Finland, the ones listed in the Pratt's guide to venture capital sources in America	questionnaires mailed to firms; phone calls used to increase response rate in Finland, use of Venture Economics as administrator in America	statistical analyses, cross-tabulations, comparisons of means, ANOVA (analysis of variance) being the test of choice
Case study	company specific data: recorded interviews annual reports, other documents, media clips	help interpret survey results, probe and illustrate the framework's practicality as a management tool	pioneer firms of the two eras of the Finnish industry, that have experienced change of owner-type	interviews of key persons, past and present; access to company documents, and media coverage	reviewing and reflecting the data against framework; discussing the interpretations with the interviewees

3 RE-FRAMING THE PHENOMENON: LOOKING AT VENTURE CAPITALISM FROM A STRATEGY LOGIC PERSPECTIVE

In this chapter, a new radar for the scanning of venture capitalism is constructed. The tool itself will not advance the functioning of the 'mechanism' but (at best) our understanding thereof – and hence allow for better decisions regarding its *future* directions.

To-date, the venture capital industry has been either too young or too pampered by growth to require *tailored* management tools for its own strategic development. Research concentrating on proving to governments, investors, and entrepreneurs that engaging venture capitalists is economically beneficial to them has serviced the primary objectives of the industry. In other words, *education of stakeholders* has been the primary concern of venture capitalists with regard to academic research. Now that venture capital organisations have grown in size and operational complexity, now that competition has intensified and markets become tougher and less predictable, now there is a call also for research concentrating on the dynamics of the business and the functioning of the venture capital organisation from the venture capitalist's own perspective and predominantly for the *venture capitalist's own education*.

3.1 Stripping the phenomenon conceptually: Rediscovering the core

Generalisations about venture capital are extremely difficult, because *venture capital* is money for investment and *not* a type of business. The businesses in receipt of venture capital run the gamut from WAP-based e-commerce start-ups to budget motels. Even as dollars (money) venture capital defies generalisations because (1) the amount and composition used to invest in each company varies

significantly from investment to investment and (2) a diverse group of providers of venture capital exists, including firms specialising in venture capital, investment banks, corporations, and individuals; each of these participants has its own style and philosophy in addition to different objectives and methods for managing the investment.[69]

Some stop here and ponder what, then, is the business that the *providers of venture capital* are in (while others will remain more interested in the moves of the money itself). We will approach this profound question by first adventuring around the venture capital concept at some length. Borrowing an anonymous quote from Mueller (1970: 113): "Business is what, if you don't do it, you have to get out of."

3.1.1 Adventuring around the venture capital concept

> "Venture capital is a means of financing the start-up, development, expansion, restructuring or acquisition of a company. Venture capital provides equity (share) capital to enterprises not quoted on a stock market and it is also referred to as private equity" (www.evca.com, 27 August 1998).

At its simplest, most tangible, and least disputed level venture capital is (indeed) *money* invested or to be invested in the ownership element in the development of equity value *in private ventures;* as illustrated by figure 9. In the words of Shames (1974: 105), "stripped to its bare essentials, a new venture consists of people, *plus* a product or service, *plus* money and time."

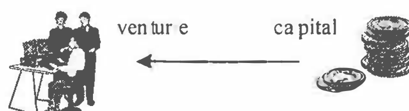

FIGURE 9 Basic ingredients of *venture capital*

Besides the actual dollars, the investment money to be placed in ventures, venture capital refers to a powerful, rapidly evolving economic phenomenon bonding together various stakeholders with differing interests. These interests have effected the definition of venture capital. The specific requirements for the *terms* of the capital participation and the *nature* of the ventures targeted for an investment to be labelled *venture capital* - and whether or not this has to do with *who* makes the investment - have varied over time and across markets.

Definitions have hence failed to hold out over time and across markets. The main debate concerns *buyouts* - whether leveraged acquisitions to purchase majority interests in mature, under-valued businesses are to be included in the sphere of the concept or not. Typically, authorities in America have debated on the issue, while they have been conceptually more liberal in Europe where venture capitalists have *from the industry's beginning* been active also on the

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69 The entire paragraph is written rephrasing the introduction of Kohlberg Kravis Roberts & Co. (1989) to leveraged buyouts.

restructuring of later-stage corporations. In America, this development started when the industry celebrated its 40th anniversary.[70]

- According to the *classic* view, venture capital is taking active *minority* ownership positions in insufficiently governed *early*-stage, *entrepreneur*-held and hence undervalued *high*-technology based companies in order to build business value that can be realised on the stock market preferably via public offerings.
- Markedly, in the *classic* view, taking active *majority* ownership positions in insufficiently governed *late*-stage, *publicly*-held and hence undervalued *low*-technology based companies in order to build business value that can be realised on the stock market preferably via public offerings is *not* to be considered venture capital.
- In the view of this study, which could be labelled either a *liberal* or a *modern* view, venture capital is taking *active ownership* positions in *insufficiently governed* and hence *undervalued* companies in order to build *business value* that *can be* realised on the stock market preferably via public offerings.

If there is no global conceptualisation unanimously agreed upon, for this economically important phenomenon, such is, in fact, missing from many individual countries as well. Perhaps the growth and increased diversity of the investment *practice*, the world over, both in terms of the number and type of players and the amount of capital pooled into the activity, has only deepened confusion and widened the definition gap. Simultaneously, the development of the industry has decreased the relevance and explanation power of the existing frameworks, each established at a given time (in 'history') and on a given market.

When pondering upon what venture capital really is, the argumentation is largely affected by the *perspective* of the observer (as outlined in chapter 2.1.1). Each stakeholder of the venture capital process, driven by their unique set of interests, entertains a different picture of what venture capital is. The behaviour of venture capital companies, understandable and acceptable to one stakeholder, may well be *disapproved* by one or more of the others.

To some, venture capital is an important *source of financing* in commercialisation of entrepreneurial ventures, while, to others, it is the *financial instrument* offering the highest yield potential among equity related products. One group sees it as an *economic mechanism* of key catalyst value in job creation in an economy. Although still inconclusive as a categorisation, yet another group of people finds venture capital as *a controversial phenomenon* involving a diversity of players that either produce, transfer, or destroy corporate value. The underlying notion herein is not entirely new (see the quote below); it has merely *not* been overly addressed in the literature to-date. Which, in turn, to an extent proves the point that sides *are* being taken.

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70 Nevertheless, the private-sector venture capital companies "have adopted a wide range of investment strategies. Some firms prefer development-stage financing, while others would rather invest in more mature companies or leveraged buyouts." (Henderson 1988: 256.)

> "In examining the meaning of venture capital, we find that it can easily vary with role ands and interests of the people involved. For instance, the entrepreneur and the financier interpret venture capital from different perspectives. If we define it by identifying those who participate in this type of underwriting, our definition would include investment bankers, commercial bankers, private financiers, small business investment companies, insurance companies and large manufacturing corporations. These investors sometimes provide initial funding to entrepreneurs at the early stages of a firm's foundation, as well as providing secondary financing to an established firm for internal expansion." (Dominguez 1974:1.)

Due to the economic significance and the wealth of ambitions around the phenomenon, any scholarly visitation aimed at its *conceptual refreshment* is likely to be under suspicion by many. Regardless of the challenge posed, exactly such is pursued in this study. Before locking *ourselves* into *only one* selected window on venture capital, the main alternative windows are stopped at for a view before 'pulling curtains on them'. But first, let us dig into the origin of the word venture capital.

Venture capital: Origin of the word

According to Reiner (1989), venture capital was introduced to the English language ca. sixty years ago in America. It was first referred to as *investment in businesses in the experimental stages*. In his presidential address to the 1939 Investment Bankers Association of America convention, Jean Witter stated: "Early financing [of an enterprise] must be done by individuals close to the management of the new undertaking who are conversant with its risks and able to take an active part in the solution of its problems" and concluded "no one in the high income tax brackets is going to provide the *venture capital* and take the risk which new enterprises and expansion require, and thereby help create new jobs, if heavy taxes take most of the profit when the transaction is successful" (Reiner 1989: 1).

Because of World War II, it took about ten more years before the people engaged in the business started to *call* their business venture capital, and before they themselves started to be called venture capitalists. This is how two industry pioneers first came across the word.[71]

> Venture capitalist A: "I just got involved with investing in small companies there on Peninsula [in 1952] and after a while they changed the name of what I was doing to venture capital, and said that I was in the venture capital business. And that is literally the way it happened."

> Venture capitalist B: "[John H.] Whitney ran across me and invited me to several of their deals. This was 1950 and the first time I heard the word venture capital. Benno Schmidt [of J. H. Whitney & Co.] is said to have claimed to have invented the word. But, as I said, our memories all get convenient. I can think of a whole lot of good ideas for which I know 20 people that claim them."

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[71] Panellists at the 1990 Venture Forum organised by Venture Economics, Inc. in San Francisco.

Wilson (1986: 17) reports Benno Schmidt's discussion on the same (Schmidt was a partner of the first renown venture capital firm, J.H. Whitney & Co., est. 1946):

> "We had a discussion at lunch one day, during which Jock [Whitney] said we needed a better way of describing our firm. We called ourselves a private investment firm but nobody knew what that meant. One of the partners offered 'risk capital investment firm' [and I suggested a refinement:] Maybe we can combine the risk element and the adventuresome element of this kind of investing by calling it a private venture capital investment firm. [Said Whitney:] That's it."

The terms used in relation to venture capital include development capital, expansion capital, risk capital, buyout financing, and private equity. Some of the concepts have been used early on as synonyms to venture capital, some as differentiating, some as specifying concepts. (See, e.g., Bylinsky 1976: 34, 42; and Klaasen and Allen 1980: 2.)

Venture capital as a *source of financing*

Many authorities have tied their definition of venture capital to the *financing* of entrepreneur-driven, new-technology based, early-stage ventures (e.g., Bygrave and Timmons 1992). The anchors of the classic approach are the fields of entrepreneurship research and finance – a good example of the combination of which is Virtanen (1996), the first thesis on venture capital in Finland.

From the perspective of the start-up entrepreneur, venture capital is, at best, the bridge from a *garage* to *public quotation*. On the other hand, the active board seats and strict covenants are seen as part of the *price* of such financing, although such could well serve the transformation of a fragile owner-managed venture to a professionally managed publicly-held corporation. In Finland, entrepreneur associations have, in fact, been advising venture capitalists that by *decreasing* their pursuit for investee control they could *increase* the demand for venture capital financing. In fact, a number of studies have investigated whether venture capitalists treat their portfolio entrepreneurs in an *acceptable* manner. A wealth of studies has over the past ten years addressed the issue whether or not venture capitalists *really* add value; often as defined by the entrepreneurs themselves.

To some authorities venture capital as a source of financing *also* covers buyouts of later-stage enterprises operating on mature industries. Studies investigating the role of venture capital at the latter end of the orporate life span often originate from *financial economics*. Authorities of the *classic* view would rather use a differentiating term for late-stage related dealings such as *buyout financing* – or *private equity* as the umbrella term to cover both.

Venture capital as a *financial instrument*

Increasingly, besides a *source* of financing, venture capital is also a *target* of financing. For an increasing number of institutional investors venture capital is an *alternative investment*, i.e., financial instruments or investment vehicles

providing participation in the private equity arena. Venture capital funds are the vehicles that bridge promising private enterprises and the capital market - two ends that could not possible meet *on their own.* Institutional investors, however, have no resources to analyse and nurture private investments. Likewise, SME entrepreneurs with insufficient collateral bases, unproved businesses, and stepwise financial needs have no direct access to them.

For funders, a particular venture capital company slow in getting its ever-larger fund vehicles invested may appear reprehensible, no matter how good returns it is able to produce on the ever-decreasing annual management fee, and regardless of the fact that pressure by the funders, as well as competition, to lower the management fees is adversely related to the increased minimum investment possible for a given fund.

Some have applied the transaction cost economics approach (Williamson 1988) on venture capital and studied venture capital companies as *intermediaries* for institutional investors (for an early European such view, see Hartmann-Wendels 1987). Seeing venture capitalists as the capital market's distribution channel to finance private enterprises, and hence understanding that venture capitalists - as *targets* of financing - must produce attractive returns from their investments to *remain* a source of financing has had some 'balancing consequences'. Entrepreneurs blaming venture capitalists for too *active* governance are no longer the only loud voices heard on the market. Investors blaming venture capitalists for too *passive* governance are being heard equally loud and clear. Government policy makers and politicians, previously tempted to echo entrepreneurs, have started to listen *anew*.

Whether venture capitalists do concentrate on maximising the well-being of their investees or their investors - or their own - will be elaborated upon later on in the study.

Venture capital as an *economic mechanism*

To governments, venture capital is a key to fostering economic growth and job creation. The insight originally derives from classic venture capital investing in the American arena. In this view, for venture capital to be *maximally* beneficial economically it should be 'classic'. Hence, a local venture capital community concentrating on buyouts of established companies may appear reprehensible to a government, regardless of potentially lower returns available for classic venture capital investments. However, referring to the new markets of Eastern Europe as the laboratory, a local economy might sometimes benefit *more* from turning established industry structures towards modern functioning and business focus than from backing completely new ventures in an unsophisticated market and underdeveloped entrepreneurial culture.

Hence, from an *economic mechanism* viewpoint, the conceptual division between early and late stage investing is a practical *political* imperative. Much thanks to the emerging *financial instrument* viewpoint, the *business* imperative

that even classic investing has to be profitable for the investor to be engaged in, is becoming better understood.[72]

In conclusion, the importance of venture capital investing to an economy, on the macro level, is well established and widely appreciated. In many economies, statistics of the economic impacts of venture capital investments - such as job creation - is systematically maintained. In fact, venture capitalists have through their industry associations systematically supported research from *each* of the above angles, in order to promote their function among each *contributing stakeholder group*. In fact, their own lobbying may have partially led to a reality where multiple views prevail on what venture capital *really* is. There is a point after which this is not in the interest of even the venture capitalist himself.

So far, the *multiple image* of the industry has resulted in significant growth of the capital pool managed by venture capital firms, growing governmental interest in stimulating classic investing, and a continued demand for such finance. Already, however, the making of investments has become more difficult as the *minimum investment sizes*, the *capital gap*, and *competition over mega-deals* have grown almost out of proportion. These are not developments forced on the venture capital companies by their stakeholders; these are consequences of strategy logic. The question being *what* and *whose* logic.

What is sometimes forgotten is that venture capital is, after all, a *business* where companies are established and run by someone to serve a certain purpose under certain corporate and organisational structure and to provide some others with certain products or services. And, in a free enterprise system, any business will grow out of natural causes in the direction where it can maximise profit and minimise risk.

3.1.2 Approaching venture capital as a *business* phenomenon: Discovering a business of *owners*

> "The venture capitalist provides medium or long-term financing in return for a proportion of the equity capital of the company it is funding. The venture capitalist may also provide 'quasi' equity, i.e., loans or bonds which may, under specific conditions, give right to share capital" (www.evca.com 27 August 1998; definition continued from above).

In the language of Brophy (1986), venture capitalists are the overseers of the market exchange system *deciding through financing decisions,* on behalf of society at large, which new projects should go forward and which should not. In this light, it is logical to define a venture capitalist as the one *making* these decisions.[73] Figure 10 presents the basic making of a venture capitalist.

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72 Besides governments, many industrial corporations view venture capital as a strategic tool, a mechanism to grasp new technologies, utilise entrepreneurial innovation, and maintain renewal. Numerous public companies - both industrial and financial - have established venture capital arms, referred to as corporate venturing units.

73 According to Webster's Ninth New Collegiate Dictionary (1989), *capitalism* refers to an economic system characterised by private or corporate ownership of capital goods, by investments that are determined by *private decision making* rather than by state control,

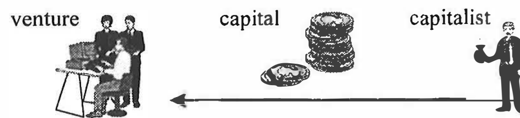

FIGURE 10 The making of a venture capitalist

For several decades already, venture capital investments have helped entrepreneurs become multi-millionaires, generated the highest investor returns to funders, and made governments happy by generating more new employment in proportion than non-venture-backed businesses, large and small. But, what sometimes goes unnoticed, *also venture capitalists* often earn big on such successes. And, perhaps, more *self-helped* than has been addressed before.

> "Venture capitalism is an active rather than a passive profession. Venture capitalists act rather than react. They respond to bad news from a portfolio company manager by visiting the company, listening to the problems, and making changes. They add value to a portfolio company by showing its principals how to do certain things, making introductions where needed, and facilitating the rapid growth and development of the company. No other class of lender or investor takes as active a role in his portfolio companies as does the venture capitalist" (Silver 1985: Preface).

The words of Silver (1985), himself a venture capitalist, are in line with the image that discourages *some* entrepreneurs from pursuing venture capital investments (those whose desire for *control* is greater than their desire for *growth.*) The viewpoint above also supports the yardstick of definitions with which this study was originally launched in Finland. There was the early insight that a venture capitalist operates as an *owner* - builder of company value - rather than a *lender* who merely sells money for a price or an *investor* that passively speculates on capital appreciation. [74] Hence the notion that perhaps venture capital is *more an ownership than finance* related phenomenon. Furthermore, supported by observations on the growing involvement of venture capital companies in buyouts and privatisations of mature corporations (referred to as control transactions) *owners* and, indeed, a *business* of owners were discovered at the heart of the phenomenon.

Figure 11 presents an early typology of ownership operators (introduced in Finland by Relander 1989: 119). The typology only confirmed the rationing behind this study by pointing attention to the *differing roles* of owners in their portfolio companies.[75]

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and by prices, production, and the distribution of goods that are determined mainly by competition in a free market

[74] According to Olafsson and Wahlbin (1985): "The involvement of the owners in the [venture capital company] decision process seems to have been much more pronounced in Sweden than [in America]... decisions to commit any substantial resources are taken by the boards, dominated by the owners."

[75] Attributing the classification principle to Olin (1986), Virtanen (1996: 111-112) acknowledges that the framework is actively used by the Finnish authorities and

	passive owner	active owner
controlling (majority) owner	holding company	*kehitysyhtiö*
non-controlling (minority) owner	investment company	venture capital company

FIGURE 11 An early typology of the ownership operators (Finland)

Assuming that all financial actors earn from providing capital to business firms, their classification could well build on differences in *how* they do it. Some *sell money for a fixed price* – a pre-set interest rate agreed between the financier and the financee. Some *buy public securities speculating on* capital appreciation and an *eventual sale for a higher price.* Yet another group of financial actors *buy ownership stakes* in companies in which they believe they can add value as active interim owners thereby *'self-helping' the prospects of eventually selling at a higher price.* These could be seen as the pigeonholes of a gross categorisation of earning logic between *lenders, investors,* and *owners* (summarised in table 5).[76]

TABLE 5 Rough classification of financial actors by basic earning logic

Financial actor	Founding principle of earning logic
LENDER:	Interest rate based fixed price of *money sold*
INVESTOR:	*Speculation* on capital appreciation of public securities
OWNER:	Self-helped capital appreciation of *actively governed* holdings

The first venture capitalists were wealthy individuals, i.e., *natural persons,* investing on their own personal account. In the next stage, they *incorporated* their investment activity by channelling their personal investments in the target ventures via the *equity* of a venture capital company. In other words, the venture capital company was created as the venture capitalist's vehicle to manage his venture capital investments. Later in the evolution, venture capitalists started to leverage their business by offering outside investors participation in their business via separate fund vehicles or by issuing non-voting stock. The key to identifying a venture capitalist was, effectively, *controlling* ownership of the venture capital company.

underscores its tool value in *excluding* some types of financing and in focusing onto others.

[76] Says Henderson (1988: 254), "the venture capitalist largely fills the role of entrepreneur in the formal capital market." In his view, a venture capitalist's *function* is to discover *information overlooked* by others. In the language of this study, this function converts into more informed and active role in governance, as an *owner.*

Since the 1960s, as venture capital has been imported to Europe, the dispersion and *institutionalisation* of ownership of venture capital companies has continued. As venture capital companies are increasingly owned by widely-held institutions, *separation of ownership from control* has progressed in venture capitalism. Hence, today, venture capitalists are predominantly *legal persons,* owned either by natural persons or legal persons whose decision-making authority is vested with natural persons (agents) acting as board members. Today, as venture capitalism has become strongly institutionalised, classic *individual* venture capitalists have become referred to as *informal* players or business angels.[77]

> "Increasingly, these investment decisions are not made by the owner of the money to be invested, but rather by a 'money manager'. He calls himself by many names, depending upon the nature of his business; but when he can decide whether weather or not to invest in the start-up or small company, he is the manager of venture capital." (Shames 1974: 107.)

This study is interested in the venture capitalist; who he is, why he engages in venture capital investing, and how he does it. The search for venture capitalist strategy logic, however, gears around the venture capital company. The vehicle through which the venture capitalist operates is the visible part of the *being* of the venture capitalist and about as close as one can get without a surgeon's knife. The following figure illustrates the making of a venture capital company at its most basic. This involves a company, a corporation or a partnership, committed to invest capital (in the equity element) in (private) ventures.

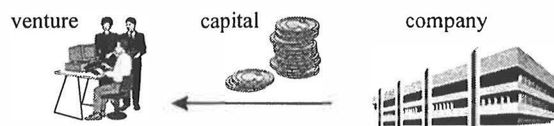

FIGURE 12 The making of a *venture capital company*

Klaasen and Allen (1980: 3) define a venture capital company as *any organisation which acts as a source of venture capital.* They also present a more formal definition, one by the Securities and Exchange Commission (release # 3968, April 29, 1964), according to which venture capital concerns companies that "engage in the business of underwriting, furnishing capital to industry, financing promotional enterprises, purchasing securities of issuers for which no ready market is in existence and reorganising companies of similar activities."

Most studies take the venture capital company for granted, and make it the starting point of investigation, not the subject.[78] Many studies go directly to

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77 The evolution of venture capitalist types will be reviewed in more detail in chapter 4.

78 In their quest to study why venture capital firms exist, Amit, Brander, and Zott (1998) make no difference between the venture capital firm (which is in their title) and venture capitalist (which they assumedly use as a synonym concept). But, then again, they ponder *why* venture capitalists exist, but not *who* they are.

the venture capital process framework, and study how a venture capital company behaves in its sphere. In the words of Elango, Fried, Hisrich, and Polonchek (1995): "Most research on venture capital has treated the industry as homogenous." Encouraged by Bygrave and Timmons (1992), whom the above study also attributes for pointing at the significant heterogeneity of the field, this study digs deeper, *behind* the venture capital process, if possible.

Typically, in venture capital research, control acquisitions (LBOs) are excluded from the sphere of the studies, even if the research subjects engage in such activity also. Even more categorically, buyout specialists are excluded. One reason could be that buyout specialists are an even more recent group of actors in the financial market than the classic venture capitalists.[79] Another reason is the misinterpretation of the classic investor's appetite for control. As will become evident from chapter 4.2.1.1, General Doriot of American Research and Development Corporation - the "father of classic venture capital in America" (Bygrave and Timmons 1992: Dedication) - preferred majority ownership stakes.

Nevertheless, the "game board" of the buyout market has resembled that of the venture capital arena since its inception. In a practitioner account, Anderson (1985: 14-15), divides the players into three categories: individual buyers, larger corporations, and smaller corporations. In his assessment, strong personal ego is a major factor to understanding the behaviour within each group.[80] Similar account by Canning (1985) differentiates conceptually between buyout specialists and venture capitalists; buyout specialists *more often* than venture capitalists seek for *direct* voting control over an investee, whereas venture capitalists *position* to back MBO teams. Over time, this difference has faded somewhat, but not entirely.

Later in this study, venture capital companies will be divided into three major categories; *entrepreneurial*, *corporate*, and *governmental*, based on whether the controlling owner of the company is a group of individual venture capital managers (partners), private sector entities, or public sector entities. This division follows the broad lines of the categories drafted earlier by, e.g., Dominguez (1974), Klaasen and Allen (1980), Davis (1986). Conveniently, also the EVCA definition for venture capital (www.evca.com, 27 August 1998; excerpted under chapter headings above) ends in the following sentence:

> "The source of venture capital can be *governmental, private organisations* or *individuals*."

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79 Started as "bootstrap" financing in the 1960s by a number of entrepreneurs who often without any equity risk formed mini-conglomerates using the LBO financing technique, the LBO became 'commercialised' by Kohlberg Kravis Roberts (KKR, est. 1976) landmark acquisition of Houdaille Machinery Company in 1979. It "opened the eyes of both corporate America and Wall Street to a new method of divestiture from the seller's standpoint and significantly increased the universe of potential buyers" (Diamond 1985: 4-8).

80 Greenberger and Sexton (1987) conclude that the amount of personal control is strongly predictive of past and future initiation of new ventures. These findings support, to some extent, the practitioner's observation. Says Mueller (1970: 161), if and when men are driven by desires for power and glory, the easiest way to obtain glory is to obtain power.

In their inquiry on *entrepreneurs'* search for venture capital, Bruno and Tyebjee (1985) profile the subject companies by ownership, the characteristics of the founders, and their survival rate. They find that the new firm is, in many ways, an "extension of its founder or founders. If the founder is strong in engineering, weak in marketing, and completely lacking financial skills, then the new company must struggle with that combination of strengths and weaknesses." In the view of this study, exactly the same rationing could be applied on venture capital companies. Perhaps differences in *ownership* of venture capital companies *themselves* offer yet undiscovered explanations regarding the *businesses* they are in.

Figure 13 bonds together the concepts of *venture, venture capital, venture capital company,* and *venture capitalist* - as conceptualised in this study - and introduces the theoretical topic areas that will be addressed next in the report: *Ownership* of the venture capital company; *strategy* world of the venture capitalist; and how these relate to the *venture capital process.*

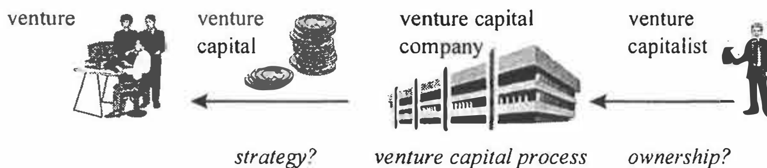

FIGURE 13 Key concepts of the study anchored together

3.2 *Ownership* of the venture capital company

"Historically, the *corporation* was controlled by its owners," says Mintzberg (1989: 303),[81] "but as shareholding became dispersed, owner control weakened; and as the corporation grew to very large size, its economic actions came to have increasing social consequences. The giant, widely held corporation came increasingly under the implicit control of its managers, and the concept of social responsibility... arose to provide them with a basis legitimacy for their actions." The study shares Mintzberg's notion that the large corporation is attached with highly political aspirations. It also shares the idea that perhaps the *teachings of organisational theory* - rather than ideas of any political extremes - will provide the tools to figure out how to bring the corporations "under adequate social control without endangering their capacity to produce efficiently." Although we may differ in *interpreting* the teachings of organisational theory, we will *look into ownership* through a much similar window. Asks Mintzberg (1989: 304):

> "Who should control the corporation? How? And for the pursuit of what goals?"

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81 First edition published in the California Management Review (Fall) in 1984.

Herein, our predominant interest and focus is in *venture capital companies* which, in many ways, are very different from large corporations. In some important ways, however, venture capital companies are similar to large corporations. Most importantly, as a concentration of significant economic power coupled with a solid financial posture - as the embodiment of oversight of the market exchange system (Brophy 1986) - the venture capital company also attracts strong political attention.

The objective of the study is not to conclude who *should* own the venture capital company; how; and for the pursuit of which goals; but it will thoroughly address the questions of who *do* control them, how, and for the pursuit of which goals. If, in the process, one combination of answers - a particular form of ownership for the venture capital company - becomes in a way stricken out over the others, it is only to be considered as a side product or an extra *dividend* accrued from the process.

Because no formal theory of *ownership* exists to be of tool value, a framework has become drafted *inductively*, inspired by Mizberg (1989). As various theories *crossing* the ownership topic will be visited along the way, the *interdisciplinary* nature of the study is at *peak* in the present chapter. Figure 14 provides an advance portrait of the framework constructed around the *ownership* issues, herein, in the *venture capital company* context.

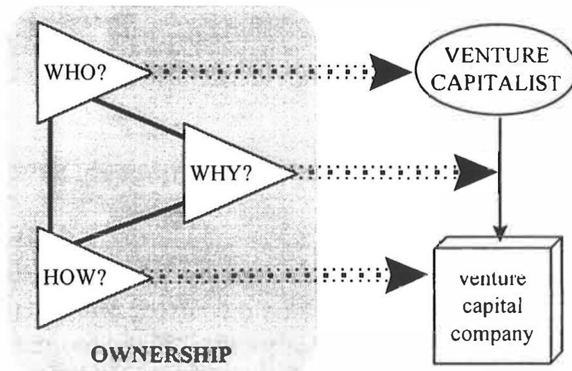

FIGURE 14 Framework of *ownership* issues in the venture capital company context

Next, before we go into studying who exactly own venture capital companies - why and how - each of the questions will be addressed at some length to lay the foundation for the quest.

3.2.1 Owners: Addressing the *who* question of ownership

Who owns the venture capital company? To begin with, a venture capital company has become defined as *any organisation* which acts as a source of venture capital (Klaasen and Allen 1980: 3). Venture capital has, in turn, become defined *broadly*; to comprise both classic venture capital and buyout investing

(Morris 1992). Now, before addressing the question *categorically*, the concept of *corporate ownership* is paid some attention.

Ownership, *per se*, is an intriguing concept, both economically and politically significant, and yet very complicated. Principally, in the legal sense of the word, ownership refers to a *set of rights* over property. There are things that cannot be owned and others that can very much be owned. While nobody can own the air that we breath, everyone very much owns the real estate property that is duly registered on his name. Ownership is clearly vested with *specifiable* economic value; the more there is of such value, or potential value, the better it tends to become protected legally and contractually.

Corporate ownership is clearly within the *specifiable* sphere: As unarguably as companies own the assets in their balance sheets, investors own the company shares in their portfolios. Dealing with *economic value* in the equation is also relatively simple as long as a company's personnel is a relatively *replaceable* resource, serving a capital-intensive business concept. But when it comes to knowledge-intensive business concepts - involving companies with basically *no* assets; companies that *lease* even the office equipment - we enter a problem area: What is the economic value of ownership of a company whose 'only assets' walk out the door every evening? Even here, the issue of *ownership* is not a problem; the company owns its registered assets (practically none), and the shareholders own every share. The problem is, instead, that the stakeholders of the firm - markedly the knowledge-employees - own (practically) all of the economic value of the firm. Which raises the notion of the *separation of ownership from control* to a totally new level.

Shareholderism and the theory of the firm

Noted with scepticism by Adam Smith 224 years ago, the shareholder corporation is a vehicle to gradually separate owners from control of their own property (Smith 1937; first edition 1776). Looking back at the century gone by, one cannot escape noting how the vehicle - particularly in the publicly-held form as documented by Berle and Means (1932) - has only accelerated during the past decade. Besides the increased *dispersion* of corporate ownership, its *institutionalisation* has become a strengthening global trend.

Companies are being owned by an ever larger number of shareholders and the shareholders are increasingly widely-held institutions themselves. In 1953, such institutions held about 15% of the equities listed on the New York Stock Exchange. Already by the mid-1980s they owned more than 53%. Hence, the 20th century has been marked by a continuous trend of (relative, not absolute) decrease in direct public-stock ownership by private individuals - and a parallel managerial revolution. (Koski: 1988: 1-2, 35.) At a point in development, in America, certain types of shareholders, markedly financial institutions, were restricted from participation in corporate governance paving way for *managerial capitalism*. According to Jensen (1989a) this development followed the restrictive laws of the 1930s, which were passed after "an outpooring of populist attacks on the investment banking and financial

community." After the withdrawal of financial institutions from active monitoring, starting in the post-war period, "managers commonly came to believe companies belonged to them and that stockholders were merely one of many stakeholders the firm had to serve."

Ownership as a political issue

> "There is a unique compatibility between the concept of entrepreneurship and the historically valued, rugged individualist. The Lockean support for individual sovereignty is played out in the economic field in the entrepreneurial arena. There is a vital nexus between the historic conservative interest in free enterprise in its most extreme form and the rebellious liberal ideology of the sixties. Much media and academic focus has been placed on this curios admixture of values." (Stevenson and Sahlman 1986.)

Almost throughout the 20th century differing ideological standings to *corporate ownership* divided the world into two. The development culminated in the *nuclear stand-off* between the East and the West - referred to as the cold war - that started almost immediately after World War II and lasted until the dissolution of the USSR in 1991. There were times during which it was not all that apparent that the stand-off between communism and capitalism would end in the triumph of the latter.

Still twenty years ago, in fact, the stand-off seemed to work a loss for capitalism. Ansoff (1982: 88-89, 109) called for the corporate management to change its attitude from that of an *embattled adversary defending an ancient truth* to an attitude of *constructive leadership in positioning the firm's role in the future society.* This was seen as the consequence of an evolution whereby the firm's environment had turned from *benign* to *hostile* and public attention from the firm's economic *contributions* to its *shortcomings*. The corporation seemed to have transformed from the *sacred cow* of economic progress to a *favourite target of control and criticism*. Ansoff (1982) marks the changes in ideology as follows: "Rejection of capitalism as a social philosophy: Rejection of private ownership... , demand for income redistribution... , nationalisation of industry... , participation by outsiders."

Mintzberg (1989: 305-306) captures the desires around the *large corporation* in a "conceptual horseshoe" – ranging from *nationalisation* to *restoration* (back to owner-control). He sees these both ends of the horseshoe as highly ideological, because to them "managerial control is illegitimate and thus must be replaced by a more acceptable form of external control." The desires are insightfully verbalised into imperatives concerning what to do with the firm - from left to right - *nationalise it, democratise it, regulate it, pressure it, trust it, ignore it, induce it,* and *restore it.* Mintzberg finds himself in strong opposition of the hard-line *restoration* philosophy "tilting" (in the horseshoe - not as a political statement) "to the left of centre." Although this study (at first sight) tilts far in the opposite direction, the world-views may not be that far apart. Cut through bone and teeth, subscribing to much of Mintzberg's analysis of the enlarged social role and significance of the large, widely-held corporation, this study seeks not to

bring *investors* back to control either. This study builds on the promise of a permanent return of the *owner* into corporate strategy reality.

In the perspective of this research, two important aspects are different from Mintzberg (1989). First, measured by the size of the organisation, extremely small companies are being addressed. Second, looked through a Finnish window of experiences (with the benefit of speaking after a leap of history), there is no nostalgia of nationalisation. Quite the contrary (having faced a *neighbouring threat* from 1917 to 1991). Mintzberg's (1989: 323) rationing is based on two arguments that are very different for venture capital companies: (i) whereas "most large corporations are simply beyond the reach of individual shareholders," venture capital firms are not and, in fact, represent a solution ("the LBO association" referred to by Jensen 1989a) to bring also large corporations (temporarily) under individual ownership; (ii) although, says Mintzberg: "While there may occasionally be shareholder *autocracy* - control of the corporation by a single important shareholder - there is never likely to be shareholder *democracy* - true control of the management by many small shareholders;" venture capital companies, often partnerships owned by *more than one but less than ten* individual partners, are a different breed.

Mintzberg emphasises that extremes are evil in many contexts and that a middle way is often the best. Looked at from a 1980s perspective, he sees the extremes as nationalisation (non-human communism) and restoration (non-human capitalism). In the perspective of this study, the extremes are stakeholderism and shareholderism; the company - the invaluable creature - being in the middle.[82] Managers are (nevertheless) still distorted in two extreme directions. Bringing in the venture capitalist, re-groomed, might offer a solution.

To Mintzberg (1989: 326) restoration of shareholder-control is a "nostalgic position... a return to our fantasies of a glorious past. In this society of giant organisations, it flies in the face of powerful economic and political forces." Behind the hard punch he acknowledges, however, that divestments (focus to core competence), doing away with vertical integration, and the strengthening of the position of the board of directors are important not only in private-sector corporations but public-sector institutions as well. Why and how would management, upon which Mintzberg puts his trust, do all this, remains unclear. While the restoration of owner-control was *nostalgic fantasy* to Minzberg (1989), a large bit of unfounded idealism goes with the other ('horseshoe') positions in view of the present study. Communism, the largest experiment of absentee

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[82] Whereas Jensen (1989b) postulates that gone is the corporation (in the words of Jensen and Meckling (1976), the "awesome social invention" into which "millions of individuals voluntarily entrust billions of dollars), it is the position of this study that the corporation is like democracy - 'not the best but the only way' to organise human interaction. No, corporations should not be run democratically, however (in the political sense of the word), but rather *nurtured like democracy*, acknowledging its shortcomings. And one of the shortcomings of the corporation is the absence of the 'kind-hearted emperor', the entrepreneurial owner.

ownership in world history, failed much due to the "trust it" principle.[83] As history has it, political waves come and go, as Kristensen (1997:4) notes:

> "There are many different kinds of capitalism, or forms of economic organisation, the evolutions of which take quite different routes and become efficient to varying degrees in terms of world competition at different points in history."

Stakeholderism as *a new alternative* theory of the firm

An originally Scandinavian theory of the firm (Näsi 1995), *stakeholder thinking*, combined with *social responsibility* aspects, has been steadily gaining ground lately both in America and Europe. In relation to the growing emphasis of *shareholder value* by corporations world-wide, *stakeholderism* offers challenging, yet *not necessarily* opposing perspectives. At an extreme end, however, the classic position of the shareholders in corporate governance - and as sole owners, in general - is being questioned. In the debate between shareholder and stakeholder extremists, characteristics can be found that resemble the classic debate over the ownership and control of the 'means of production', which was expected to have been buried with communism.

There is no denial of the influence of the *various stakeholder groups* on the corporation. Displeased employees are known to have joined forces in extreme cases to change the entire corporate ownership system via political revolutions, as well as to pursue less violent objectives.[84] Nevertheless, keen to bring a contribution to our theory of the firm, this study *builds on* the neo-classic perspective (shareholderism), but *derives insight from* stakeholder thinking. In the view of this study, companies exist to produce a maximal return on investment to shareholders. The notion that other stakeholders sometimes legally own the most important asset attached to the firm - notably employees in knowledge-intensive businesses - call attention to the somewhat mechanistic perspective represented by the neo-classic position. In this study, a conceptual difference is made between *owners* and *investors*. Where the stakeholder theory views the managers and the firm as a single entity and investors as just another stakeholder group; and where the neo-classic theory views the investors and the firm as a single entity and the managers as their agents with conflicting interests; this study views the owners and the firm as a single entity and investors and managers both as stakeholder groups.

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[83] Baxter and Rarick (1989), working from a 'realistic' perspective to understand ethical behaviour, conclude that "a culture of self-giving love might provide the support for 'free moral agents' to become Kierkegaard's 'Knights of Faith'." While of contribution as another framework of 'mapping the way' to such a culture or operational environment, the day is far out before human beings - by themselves - ever get there.

[84] In Finland, an episode was witnessed in 1999, whereby a large insurance company first announced laying off employees and, shortly thereafter, proposed a large one-time bonus dividend pay-out to shareholders. The labour unions immediately threatened to boycott the company and take their business elsewhere, causing the company to reverse their firing decision. In the process, the power of corporate *stakeholder groups* such as employees (at least where labour unions are strong), consumers (who can vote with their feet), and media (whose role in depicting reality is integral) over corporate decisions was made publicly evident.

Stakeholderism has been addressed constructively before by shareholderists. Jensen (1989a) points at evidence suggesting that control transactions create value that comes from real increases in productivity, "rather than from simple wealth transfers to shareholders from other parties such as creditors, labour, government, customers, or suppliers." In his view, "even the most voracious maximiser of stockholder wealth must care about the other constituencies of the corporation." Since shareholders have the natural incentive to service the parties that can affect their business "by influencing the terms on which they contract with the organisation, or through the threat of restrictive regulation or decline in reputation," there is no conflict between the stakeholder theory and the theory of the firm (Jensen and Meckling 1976).

Ownership as a national issue

> "Foreign ownership, i.e., foreign capital - is not only a corporate issue but also a national issue. The nationalities of investors - and the consequent behavioural patterns dictated by the capital markets they are used to operating in - partially define the 'investor group' (as used in this study) to which they belong. Of course, nation states use foreign ownership legislation to control the relationship between domestic and foreign ownership as well as between non-voting and voting shares of foreign owners in order to restrict threats of the 'buying-the-country' type." Koski (1988: 108-109).

In political history, desire for control over other countries' natural resources, land, facilities, and labour - and the attempted acquisitions thereof - have been reasons enough for war.[85] Not until recently, on an increasingly global scale, it has been possible to save blood and simply *buy* them up. In Finland, there has been an active discussion over the passed few years on the diminishing 'blue-and-white' ownership. For example, after Finland abolished foreign ownership restrictions in the early 1990s and joined the EU in 1995, foreign ownership of Helsinki Stock Exchange listed companies has increased phenomenally. With regard to venture capital, we may conclude, the ownership of control - rather than capital - is what matters, however.

There is also another aspect to ownership as a national issue to be addressed. Namely, *national patterns of ownership* (which will be returned to in chapter 3.2.3 as a governance related issue). In continental Europe, reportedly in the Netherlands (Iterson 1997: 58-60) and Germany, closely-held owner-managed SMEs have co-existed with large corporations boasting high degree of dispersion of ownership and control. While the German pattern of ownership has prevailed, regardless of the devastation of the two world wars (or thanks to them), the British pattern of ownership went through a transformation, culminating in the early 1960s. (Lane 1997: 65-66).

Discovering a particularly strong pattern of interfirm co-ordination in Germany, Lane (1997: 65-66) characterises the tradition with an exceptionally

[85] "Most of the excitement and repulsion which *The Prince* has generated comes from its frank acknowledgement that in practice successful governments are always ready to act ruthlessly to attain their ends." George Bull in his translator's introduction to *The Prince* (Machiavelli, p. 24, 1981).

high degree of interconnectedness between companies, cartels, and communities of interest for profit pooling, protected via cross-shareholding of the companies involved. In contrast, firms in the UK remain highly atomised economic actors, handling risk by highly dispersed shareholding rather than by pooling risk through cross-shareholding and collective agreements.

The national patterns of ownership of industrial firms communicate with the social identities and role understandings of owners and managers. German owners are said to be much more locked into and identify with their firms – developing an 'ownership-psychology' based on long-term time horizons and an emphasis on stable growth, rather than short term gains. In the UK, where stock market developments have worked towards increasing dispersion of share ownership since the 1930s, the stock of a given firm is more easily regarded as a financial asset to be moved on the market, and owners develop less strong identification with the companies they are shareholders in. (Lane 1997: 66-67)

One of the early European contributions to corporate ownership discussion is a study titled 'The holding company and corporate control' by Daems (1978). Apart from its seminal nature in identifying and depicting the nature of businesses operating in the corporate ownership arena (or on the market for corporate control), the study offers insight into the development of the Belgian financial market and, as such, into differences between European and American traditions herein. Daems (1978: 2-3) defines control (over a company) as *"having the control instruments* (representation on the board of directors or a 'substantial' share of equity capital) *needed to monitor capital management in a company."* In the Belgian market, holding companies were discovered to act as financial intermediaries, in many ways similar to closed mutual funds: "The basic difference is that holding companies strive for control over corporate decision-making." The holding companies were depicted as institutions for organising and structuring the corporate control market, able to acquire control of even the largest corporations in the economy via the issuance of own shares and securities.

Venture capital firm as an *ownership* vehicle

Daems (1978: 4-5, 25) who examined the role of *holding companies* in the Belgian economy was amazed on how little attention "non-Marxian economists" had paid to the economic analysis of the holding company, the "key institution through which European and Japanese combines manage and control their multicompany systems." He attributes the lack of attention to America's legal restrictions on corporate control (Jensen 1989a, referred to above) which, by the late 1970s, had constituted for the new continent's evolution towards "managerial capitalism and not financial capitalism."[86] In the development of

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[86] Daemns (1978: 25) acknowledges that this is a disputable conclusion. One closing to the debate is the position of Jensen (1989b), according to which the publicly-held corporations, and hence 'managerial capitalism', have outlived their usefulness in many

Europe, financial intermediaries had played a bigger role than in America and, says Daems, "it is crucial for an understanding of the financial intermediation in Europe to speculate... about the historical reasons for these remarkable differences between [America and Europe]."

In the view of Daems (1978: 5), theory had fallen short of understanding "the holding company phenomenon" because of the "failure of economists to come to grips with... the concept of corporate control." The "essential characteristic of every battle over corporate control: Conflicting interests among 'rival decision-makers' and the consequent lack of unanimity" had been ignored. In his assessment (Daems 1978: 93), most neo-classic theories had either "ignored the influence of this desire for control on resource allocation or... tried to demonstrate that the problem is irrelevant." Agency theory, particularly since Jensen and Meckling (1976), has widened the window, but perhaps not quite wide enough to understand the expanded scope and increased diversity of the corporate ownership arena. Whereas Daems (1978: 5) sought to formulate foundations for theories of "holding company behaviour" and "corporate control," the present study finds itself continuing his work only from a different starting point and under somewhat differing terminology.

In the conclusion of Daems (1978: 35-36): "The holding company structure is probably the poorest way in modern economy to organise control, which apparently is the central business of the large Belgian holding company." Deriving from the notion that holding companies had been around ("issuing publicly financial claims to hold claims in companies with the objective of monitoring these companies financially and otherwise, if necessary") for roughly 150 years, he ponders upon the reasons of the holding company's survival as follows:

> "From the point of view of organising control it appears therefore that the large Belgian holding company, probably by a lack of aggressive competition, has not followed the organisational innovation introduced by American management and continues to rely more on trustworthy people than on efficient organisation."

Ideally, says Daems (1978: 65-66), the discretionary control over resource allocation in the hands of a few decision-makers should be studied by analysing the concentration of decision-making power in decision units: "Such decision units may control resource allocation in several judicial entities. The question that counts for concentration and competition is not how production and legal structures are organised but how discretionary power over economic decision-making is organised. It is the real side that matters for the allocation and allocation efficiency - not the legal side."[87]

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sectors of the economy; a development culminating in the coming of "the new financial capitalists" - and 'financial capitalism' (Baker and Smith 1998).

[87] To Fama (1980) the concept of the ownership of the firm is irrelevant as long as the *entrepreneur* is out of the picture, which is the case with large corporations, because such cannot be owned by entrepreneurs. In the view of the present study, the LP fund vehicle makes it possible for an *entrepreneurial team* to gain such control.

Who own the venture capital companies?

In their study of entrepreneurs' prospects in attracting venture capital, Bruno and Tyebjee (1985) conclude that "the question of how to divide ownership of the company among these original founders is an extremely challenging one and not easily resolvable. The division of ownership must reflect past, present, and future contributions to the success of the enterprise. In addition, the probability of the premature departure of a founder to the detriment of the start-up must be minimised. Probably the most satisfactory approach to the problem is to use a vesting provision that accrues common stock ownership over time, thus inhibiting premature departures." There is no reason to believe that this question is of any less relevance with regard to venture capital company start-ups and their eventual success.

Regardless of who *actually holds* control (importance of which underlined by Daems 1978), this study focuses on the persons (natural persons or legal persons) who *legally own* the control - with which goes responsibility - of the business (as venture capitalists). This leads us to study, precisely, *ownership of control over the venture capital company* as the relevant identity for a venture capitalist. Already Klaasen and Allen (1980: 3) concluded that "the forms of ownership for venture capital businesses are varied." Some venture capital firms are *owner-managed,* while others are absentee-owned. Respectively, some venture capitalists are owner-managers, while others are left (in the words of Berle and Means 1932: 68) "with a mere symbol of ownership, while power, the responsibility and the substance which have been integral part of ownership in the past are being transferred to a separate group in whose hands lies control."

As mentioned in chapter 1.3 above, venture capital companies fall into two predominant categories; companies that utilise separate limited-life LP fund vehicles and companies that utilise a single LTD structure. In both cases, the controlling shareholder or group or shareholders of the venture capital company is identified as the venture capitalist. In the case of the former, funders do not participate in the ownership of the venture capital company but, instead, that of the LP funds and in the role of limited partners. In the case of the latter, funders participate in the ownership of the venture capital company alongside with the venture capitalist. This comprises an interesting differentiating factor in the legal (judicial) structure of ownership of the venture capital company. The limited partners of LP funds own no shares in venture capital companies themselves and, by definition, very limited extent of control even in individual fund vehicles. Oftentimes, they are forbidden *by law* from exercising control; otherwise they would lose their limited partner (limited liability) status both legally and fiscally. In the LTD setting, there can be different classes of shares granting different rights as to voting power and the dividend pecking order. At an extreme, one shareholder can own non-voting shares compensated by a preferred dividend status, while another shareholder owns all the voting power. In summary, with reference to the discussion about separation of ownership from control, all owners of a company's equity do not necessarily *own* control *in the first place*.

In summary, in the language of this study, ownership refers to *ownership of control* of the business firm and, more particularly, to that *of a venture capital company*. The classic venture capitalist is an owner with a face: An entrepreneur in the classic sense of the word, who only operates in the market for corporate control rather than in operative business. Other than by individual entrepreneurs, venture capital companies can be owned either by private sector or public sector entities. In chapter 4, the evolution of the *entrepreneurial, corporate*, and *governmental* venture capitalist categories (boxed in figure 15) will be addressed.

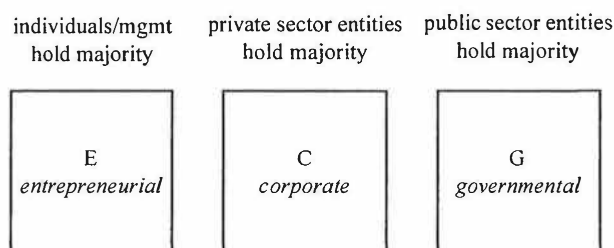

FIGURE 15 Pigeonholes for basic owner types

Now that we have analysed the make-up of the faces of venture capitalism we can move to pondering upon *what* they are for.

3.2.2 Mission: Addressing the *why* question of ownership

> "Equity capital invested in a company by its shareholders is an important resource. Personally, I have always emphasised that personnel is more than a resource. Being human beings. Shareholders, too, are more than a resource. Besides equity, they give the company its mission." Ahti Hirvonen, former President of the Union Bank of Finland, a predecessor of MeritaNordbanken (Kauppalehti Optio 1999: March25).

All types of organisations - formal and informal, non-profit and for-profit (as well as many individuals) - have a mission in life. A mission is of good guidance in deciding upon one's action and making judgement calls between different options. A clearly understood mission is particularly helpful under an extreme turmoil or stress. It is noteworthy that a company's mission does not necessarily have to relate to achieving maximal, *directly financial* returns. And this is not necessarily the case with each venture capital company either.

Veranen (1996) describes vividly the circumstances under which this research became initiated. Perhaps the Finnish circumstances (until the early 1990s recession) helped bring up the issue of ownership - the questions of who owns, why, and how - and its potential effect on operational dynamics and strategy logic *also* in the venture capital context. This is a context dominated by the American tradition, where venture capitalists are typically envisioned as

individual general partners of LP fund vehicles who are primarily driven by maximal direct financial returns from venture capital investments.

> "In a significant portion of Finnish businesses ownership has been 'strategic' to this date... State companies, for example, have had the mission of industrialising Finland. Co-operatives, in turn, have primarily served as the refiners and marketers of their members' production. Many family companies have operated as symbols of family bondage. Owners have not even considered it their right to benefit economically, while feeling obliged to transfer their inherited wealth to the next generation. Ownerships by banks and insurance companies have, in certain cases, predominantly sought to secure continued customer relations and to minimise credit risks. Additionally, a significant portion of Finnish businesses have been cross-owned. This has primarily been in order to cement power and not to maximise profit." (Veranen 1996: 15-16; translated from Finnish by the researcher.)

In the language of this study, the mission of a business firm is an issue of its owners. At the birth of an enterprise, the mission is set by the founding shareholders. In fact, missions emerge *before* companies are incorporated, i.e., firms are established to serve missions - not *vice versa*. Sometimes it happens, though, that recently established companies rapidly venture beyond their initial mission and the founding shareholders have no resources to refine it successfully. It may also happen that well-established companies gradually lose the clarity of mission. For these companies, missions need to be *re-established* by intervening shareholders in order to unlock full shareholder value, or simply to *salvage* value.

Stakeholders, other than the founding owners, joining a business along the way, contract their resource exchange with the firm sometimes largely based on their perception of the company's mission. Hence, if the mission is poorly communicated - unintentionally or not - or, worse yet, if it is changed dramatically without communication to stakeholders, there may be strong disappointments in expectations.

For a company owned by only one individual, the mission is all packed, compactly for a research object, between two ears. In a source that concrete and touchable, absolutely true data is so close; and yet so inaccessible. There is no assurance whatsoever that a mere verbally communicated mission statement by such person is the absolute truth - or that even a written, non-binding statement is a true driving force and reason for existence for the enterprise. With regard to more widely-owned enterprises, there is a need to discuss and agree on the mission among shareholders, and to document it as a binding guideline and benchmark for the management. Legally speaking, due to conflicts of interest, a written mission statement of a multi-owner company must be binding. Otherwise, if for example four out of five shareholders secretly pursue a hidden mission, the four constitute a legitimate agency risk to the fifth. A clearly documented mission statement - and sticking to it - also helps set stakeholder expectations right from the beginning.

Needless to say - given the economic significance of venture capital investing and the sheer power vested in the control of it in the modern economy - a well-understood and communicated mission statement is

important for a venture capital company. As was concluded above, venture capital companies are owned by one or more individuals, one or more corporate or institutional entities, or a combination thereof. Furthermore, funders are integrated in the venture capital organisation either as limited partners of separate fund vehicles or as investor-shareholders of the venture capital company itself - either without any voting power, with limited voting power, or with full voting power.

"Because the holding company is a financial institution for corporate control, its investment strategy can pursue different objectives. These strategies effect the industrial structure of the economy and could lead to a structural weakness and an economic retardation." (Daems 1978: 135-136.) With reference to the above discussion, it is not necessarily the simplest of tasks to establish *whose*, let alone *what* missions venture capital companies *actually* serve.

The importance of bearing *mission* clear in one's mind

Bearing mission clear in one's mind is particularly vital under extreme leadership pressure, such as at times of war. [88] The clarity of why to exist and what to pursue is increasingly important for successful management of business as well. Today's competitive environment is experiencing rapid transition towards increased cultural mixture of personnel and markets addressed; shortened product, company, and even industry life cycles; and exploded streams of information - including the almost paradoxical uncertainty over the long-term impact of the Internet to business and industry structures and, on the shorter term, even to basic elements of the value chain such as distribution and marketing. In times like these, *bearing mission clear in mind*, operationalised into workable short and medium term objectives, is particularly important. First, it has to be clearly established *what* the mission is.

Mission deals with identifying the core purpose for an entity's existence: Setting the *basics* for how the entity is to earn its living. Classically, generating profits from an economic activity is the mission of a business firm and doing this successfully - producing a *competitive* return on equity - its way of earning a living. As a logical conclusion, in a market economy, a firm not fulfilling its mission does not earn to live. In this context, *competitive profitability* could be thought of as *food* without enough of which a living creature cannot survive. As another conclusion, firms not generating profits or ones generating very poor profits year after year, but still left alive by their owners, are *evidently* earning their living by serving some other, less transparent function, than the generation of *directly financial* gains.

In their study on how venture capital firms differ, Elango, Fried, Hisrich, and Polonchek (1995) did not include mission among the potential factors studied. They do conclude, however, based on their survey findings, that the overall goals of firms may also differ. They found some companies indicating

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[88] The *empirically proven* importance of *clarity of mission* is acknowledged by renowned military leadership schools such as *RUK* (the Reserve Officer School of the Finnish army)..

"that they were different because they were 'strategic investors'. These firms are managing money provided by operating companies in furtherance of a particular strategic goal, such as having window on new technology... This difference in overall purpose may lead to other differences in behaviour."

Bygrave (1989: 143) concludes that, in venture capital, investors send funds to venture capital companies to be channelled to those portfolio companies that offer the best potential to become publicly listed or acquired by third parties. It seems evident that the mission of a venture capital company is to realise maximal returns from private equity investments.

The entire debate on whether or not a venture capital company adds value builds on differing fundamentals depending on the chosen perspective. According to some entrepreneur-driven arguments, a venture capital company's value-added is a measure of hours spent per week on an investee venture's board room or factory floor. From the funders' perspective, value-added is the delta between returned and invested capital in a venture capital fund vehicle as a function of time. Governments, on the other hand, calculate the new jobs created by venture-backed vs. non-venture-backed companies. The owners of venture capital companies measure value-added under yet different, not necessarily all that unanimous criteria.

In the language of this study, the owners of a venture capital company establish the firm to serve a particular mission. They organise for the mission's fulfilment and govern - if not manage personally - the seeking thereof. As to a venture capital company owned by only one individual, the linkage between ownership, mission, and governance constitutes no Pandora's box. The true mission may still be impossible to grasp, but there are no interests conflicting with regard to its fulfilment. But once there are more than one individual or one or more widely-owned corporate entities, or a mixture thereof, owning the venture capital company, the risks related to such conflicts of interests are exponentially increased. Given the economic significance of venture capital, the colliding interests of the owners and other stakeholders of the venture capital company may - at worst - boil to a *devious cocktail* or a Pandora's box (which is 'daring' to touch or open). The two basic categories of missions of venture capital companies, direct/financial and indirect/strategic, are inserted in the boxes of venture capital company ownership in figure 16.

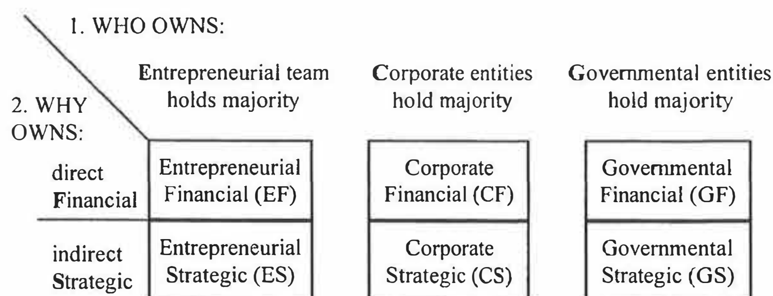

FIGURE 16 Pigeonholes for basic owner types and missions

In summary, venture capital firm are vehicles of their owners established to serve certain missions. *How,* the ones *who* own, control for *why* a firm exists, is referred to as *governance* in this study. A bridge from mission to governance issues of a venture capital firms is built-in in the following concerns of Kierulff (1986: 146-147) who calls for more attention on the roles and responsibilities of the private vs. public sector venture capitalists: *What constitutes ethical and unethical behaviour in the industry? How is unethical behaviour policed? How does/can the industry maintain an image of responsibility to the public good?*

3.2.3 Governance: Addressing the *how* question of ownership

> "A venture capital firm performs economic functions similar to those of a corporation. Both raise capital from outsiders and invest in projects on behalf of the outside investors. The outside investors in both cases create a governance structure for monitoring the decisions made by the agents." (Sahlman 1990.)

Historically, concern for company governance is rooted in the separation of ownership from control which, in turn, deals with the dispersion of shareholder base in large corporations and the increased distance between the shareholders and the management of corporations. In many public corporations, the largest shareholders own less than 10% of the company's equity. The dispersion concern is further underlined by the fact that, increasingly, many of the largest shareholders (pension funds, etc.) of the public corporations pose even more dispersed ownership bases than the corporations themselves.

> The separation of ownership from control produces a condition where the interests of owner and of ultimate manager may, and often do, diverge, and where many of the checks which formerly operated to limit the use of power disappear... In creating these new relationships, the quasi-public corporation may fairly be said to work a revolution. It... has divided ownership into nominal ownership and the power formerly joined to it. Thereby the corporation has changed the nature of profit-seeking enterprise. (Berle and Means 1933: 6-7)

Deriving from the theory of the firm (Jensen and Meckling 1976), there are profound differences in the complexity of governance between *differently* owned enterprises. In owner-managed firms owners themselves manage the business, whereas in publicly-held entities, owners exercise governance via representatives (agents). It is common in the public corporation setting that the *agents* of institutional shareholders (such as pension funds) together appoint 'third-person' *agents* as board members to monitor the hired corporate management.

As pointed out colourfully by Towbin (1983), conflicts of interest between management and shareholders emerged once the firm has gone public: "The company plane in Palm Beach in February is harder to explain when the business has several hundred partners (stockholders) than if ownership is concentrated in few hands. Perquisites, such as expense accounts, country clubs, and travel must be more carefully scrutinised." Decisions regarding company

direction "will have to be carefully thought out and justified by facts and figures rather than being intuitive, 'seat of the pants' decisions."[89]

As testified by Adler (1983), venture capitalists hate to see money wasted: "Every dollar must be marshalled very carefully if the business is to be assured of survival." An entrepreneur's focus on such things as the size of his car, office, etc., usually indicate "a mental approach and lack of dedication that would divert his attention away from developing a major business." Such a man "tends to be thinking more like an employee than a partner" and is not so concerned how much "his share of the equity is being dissipated by such high capital expenditure." Venture capital firms are not free from these concerns.

In the 1980s, LBO specialists emerged to engineer take-overs of poorly managed companies.[90] Their wave was later joined by established venture capital groups both in America and Europe. This expansion of activity has not been welcomed by all observers of the industry, as it tampers established power structures.[91] In this study, the primary governance related measure that will be used relates to dispersion of ownership. We shall, first and foremost, examine whether a venture capital company has a *uniform* or a *dispersed* owner base. In figure 17, this profound governance-related factor is inserted in the boxes whereby the framework of ownership-related issues becomes completed and a basic typology of differently-owned venture capital companies is completed.

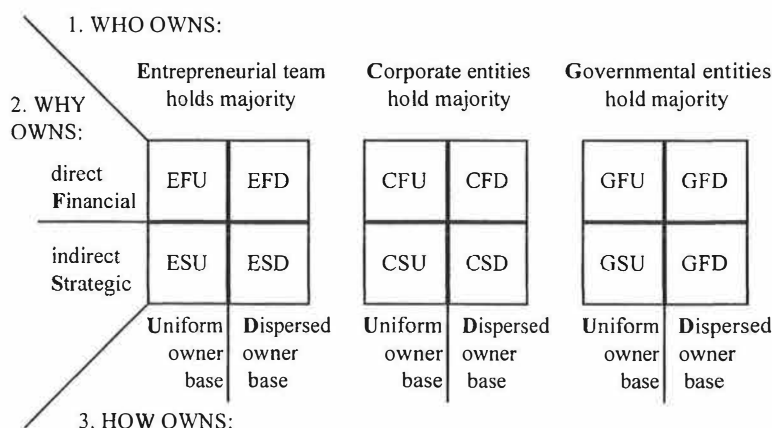

FIGURE 17 Pigeonholes for basic owner types, missions, and widths of owner base

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89 Differences in governance expectedly result in differences in corporate culture and operational dynamics. Classically, a contrast can be envisioned between large, bureaucratic, hierarchical public entities and small, casual, lean entrepreneur-driven ones.

90 Financial economics can be said to have greatly contributed to the evaluation of management efficiency in employing corporate resources. For example, the addressing of the dynamics of an optimal capital structure (e.g., Myers 1984) has provided venture capitalists - as well as corporate management - with tools to monitor and improve capital-use efficiency; undoubtedly, to the benefit of the society at large.

91 Even as a point by a *consultant* (Bowles 1990), the idea that a *tightly drawn strategic plan* is an *effective* and *logical* vehicle for a corporate management to *defend its solvency* against shareholders indicates how concrete an issue the *separation* of ownership from control is.

Besides the *width of a company's owner base*, its governance is affected by national or cultural values, principles, and practices, as will be discussed below. In corrupt economies, multiple layers of agents in company governance can easily turn into a factor significantly complicating business success.[92] We shall next address *national* and *cultural* differences in governance traditions.

National/cultural differences in governance

> "We enquire about the dynamics of industrial adaptation and change from the starting point that managers have to act in social formations which have already developed distinctive ways of governing work and firms. These governance principles have been created through centuries of institutional experiments during which social groups both affected and were themselves affected by the social space these institutions helped provide. The nature of firms is an outcome of this social process, which embeds them in social relations, enabling them to interact with other firms in fairly predictable ways facilitating transactions, hiring workers, engaging in risky projects believing that financial institutions, public R&D, professional groups from educational organisations, etc., will share these risks by engaging in these projects, given that the firm acts according to the rules of the game established by the distinct nation's 'system of governance'." Kristensen (1988:6).

Instead of purely financial rationale, economic transactions are embedded in *social relations* which may effectively govern behaviour and strategic interaction between organisations, and which vary across nations and cultures (Kristensen 1997: 6-8).

According to Whitley (1997: 236-237), the question of *organisation of ownership and control of economic activities* is integral to capitalist society. He finds strong difference between market economies in which owners typically are *directly involved* in the management of economic activities and those in which they *delegate control to non-owning managers*. Also, says Whitley, the extent to which share ownership *overlaps with other business relationships* between companies differs greatly between *capital-market* based financial systems such as the anglo-American economies and *bank-dominated* ones such as Japan and Germany.

Discovering a particularly strong pattern of inter-firm co-ordination in Germany, Lane (1997: 65-66) characterises the tradition with an exceptionally high degree of interconnectedness between companies, cartels, and communities of interest for profit pooling, protected via cross-shareholding of the companies involved. In contrast, firms in the UK remain highly atomised economic actors, handling risk by highly dispersed shareholding rather than by pooling risk through cross-shareholding and collective agreements. According to Kristensen (1997: 41), it has become legitimate, in the UK, for any group to exploit any changes in market terms to their fullest extent when choosing strategies. In Germany, individual groups would "engage in a structured game

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92 Much due to human nature, agents on top of agents (as entertaining as this is in the *James Bond* context) may work disasters. An entire concept for economic system fell largely due to agency problems, and such have been addressed in a wave of shareholder activism also in the market economy since the 1980s, via LBO based control transactions. Recently, Soros (1999) underlined the crisis of *the increasingly faceless* global capitalism.

of bureaucratic negotiation, only indirectly taking advantage of changes in market terms, to improve their social situation."

The national patterns of ownership of industrial firms communicate with the social identities and role understandings of owners and managers. German owners are said to be much more locked into and identify with their firms - developing an ownership psychology based on long-term time horizons and an emphasis on stable growth, rather than short term gains. In the UK, where stock market developments have worked towards increasing dispersion of share ownership since the 1930s, the stock of a given firm is more easily regarded as a financial asset to be moved on the market, and owners develop less strong identification with the companies they are shareholders in. (Lane 1997: 66-67). In their study of European venture capital activity, Tyebjee and Vickery (1988) conclude that Europeans are, overall, not receptive to outside owners. This, they find, is the case particularly with Germany, whereas the UK is found to be of closer kin to America.

The term is still so fresh, for example in Finland, that no established local translation exists. *Osakeyhtiön johtamisen valvonta* (e. the monitoring of the managing of a corporation), introduced by Ruuhela and Laitinen (1997), does not sound quite that marketable yet.[93] The concept itself is not new to the Finnish arena, however. Koski (1988: 105) describes corporate governance as a *mediation process* between the operating board, the board of directors, and the supervisory board. He underscores that most of the information concerning a company's internal and external status is provided to shareholders *and* stakeholders through the mediation process. Conversely, says Koski (1988: 105) "the mediation process interprets signals/reactions and commands of the shareholders and stakeholders to be executed by corporate management."

Governance inseparability

Argyres and Liebeskind (1999) propose that *prior contractual commitments* made by a firm can limit its ability to differentiate or change its *governance arrangement* in the future.[94] In their view, changes in bargaining power between a firm and its exchange partners also can result in *governance inseparability,* which they define as "a condition in which a firm's past governance choices significantly influence the range and types of governance mechanisms that it can adopt in the future periods." In their view, *different firms* may govern *identical transactions* in *different ways,* as long as each firm is also a party to other types of transactions. In their thinking, these differences are most pronounced between companies of different age: The older the firm, the more it will be obligated to using hierarchical mechanisms to govern generic transactions. The same applies to firms operating in countries where the relative bargaining power of labour unions is high. Germany and France are noted as examples.

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93 Ruuhela and Laitinen (1997) make a good presentation of national (cultural) differences between corporate governance structures.

94 Herein, their reasoning is being applied to *corporate* governance, in particular.

In the perspective of Pfeffer and Salancik (1978), organisations choose governance forms that keep them exempt for reliance on other organisations for critical resources - pursuing for long-term contracts and mergers and acquisitions. Argyres and Liebeskind (1999) find companies alert for power-seeking attempts of others and, hence, differ from the Pfeffer and Salancik approach in that they associate the concept of power with particular market structures created by entry barriers and/or collective action - not by the mere needs of companies for inputs or other resources. Argyres and Liebeskind find firms gaining power from "difficult-to-anticipate changes in underlying economic structures."

Because governance inseparability limits the governance options available to any particular firm, Argyres and Liebeskind (1999) propose (addressing the quest of Coase [1937] concerning the limits to the size and scope of a firm) that a single firm can only engage in a *limited set of transactions* that can be more or less efficiently governed *by its particular set of feasible governance options*. In short, they postulate that the *history* of choices of the firm sets the limits for its *future* growth and diversification, due to "constant challenge by new entrants burdened with no such limiting framework." Their thesis speaks for constant corporate renewal: Calling for it, from one hand, and illustrating how difficult, if not impossible, it is to make or keep it happening.

> "For instance, in the early stages of an industry, some firms may make choices to produce a given output internally, whereas other firms may choose to outsource this input. Over time one or the other choice may prove to yield a higher net surplus. However, it may be extremely difficult for any firm to change its governance arrangements over time, if its initial governance choices involved entering into commitments that engender governance inseparability. Thus, because commitments may foreclose future opportunities to adjust to more efficient governance modes, the governance choices that firms make early in their development may well determine their long-run competitive success... We assume here that these early commitments are made in at least a boundedly rational way and are not merely the result of random processes. However, when circumstances change, the constraints on governance choices that follow these commitments may restrict a firm's ability to adapt to changes in circumstances." Argyres and Liebeskind (1999).

Mintzberg, Brunet, and Waters (1986: 37-38) tracked the strategies of Air Canada during 1937-1976 and concluded how ironical it was that the more independent Air Canada grew from its government owner, while at the same time seeming to develop a good control of its own markets, the company "became increasingly locked into its industry structure as well." One of the factors that led to the corporation's "planning orientation" was its status as a government organisation which meant an incentive to avoid the attention of politicians, i.e., surprises and bad publicity. Referring to earlier evidence by Mintzberg (1979: 288-291), they point that "the effect of any form of external control is to drive an organisation to a highly analytic mode of functioning - never to act impulsively, to justify all of its moves with hard data, in general to be systematic and orderly." This is a view echoed by Ansoff (1988: 172): "In this perspective, the wonder is not that competitively competent organisation will

resist strategic planning, the wonder is that top-management coercion can sometimes force strategic planning to take root in the organisation."

In the language of Argyres and Liebeskind (1999), when the operating environment is highly demanding, change will take place through *the death of firms that are burdened with inescapable governance inseparabilities*, to be replaced by other less-constrained firms.

Ownership and strategy

As if paving way for Argyres and Liebeskind (1999), Koski (1988: 125-126) addressed the importance of realising that once ownership strategies are set up, they are difficult to change: "Many actions are therefore irreversible. Restructuring, from this point of view, seems to lead to situations in which structure starts defining strategies." According to Stevenson and Harmeling (1990), a *venture capitalist's* position and approach to change is "both a result of internal change and a consequence of conscious and accidental influences from the organisations and the societies in which the individual is embedded."

Koski (1988: 8-13) defines a corporation as a *pool of productive assets*, the balanced growth and profitability of which, on the long term, is the mission of corporate management. Insightfully, corporate management is seen as the manager of both *business portfolio* and *ownership portfolio*:

> "The aim of management is to develop the structure of the ownership portfolio in such a way that there is no conflict between the business objectives of the corporation and investment objectives of the major owner groups... At any given moment, the existing ownership structure naturally limits corporate management's decision-making freedom to choose new candidates for the ownership portfolio."

This study is interested in the governance of venture capital companies and the increased complexity thereof as the field has developed towards more sophisticated legal structures and dispersed ownership bases. Particularly, the study is interested in exploring linkages between ownership and strategy of the venture capital firm. With ownership issues introduced and a framework established (figure 14), we may continue to the arena of strategy. As a conclusion so far, there is reason to expect that ownership has something to do with strategy and operational dynamism, in the venture capital company context, as well as with the ability to *change* strategy and operational dynamism.

Fligstein (1985) studied the spread of the multidivisional form in large companies and concluded that, for organisational change to take place, *someone* in the organisation must *interpret its external and internal environment*, but not necessarily directly reflecting the market forces or perfect rationality. In his words, "the link between the corporate power struggle and various shifts in strategy needs to be explored." To him, the interesting question is: *Does strategy cause a certain type of structural power base to dominate the firm, or vice versa?*

3.3 *Strategy world* of the venture capitalist

The objective of this chapter is to (conceptually) anchor the framework building to corporate strategy research. Even though the exploration reported herein is highly inductive by nature - driven more by observations of practical phenomena than hypotheses derived from existing theories - the observing has, all the time, taken place through certain theoretical lenses, or eyeglasses as insightfully depicted by Näsi (1987).

The landmarks of corporate strategy literature, that have had the greatest influence on the researcher's own strategy thinking and, hence, on the framework building of the present study include, besides the seminal Finnish corporate strategy guide (Näsi 1987), Ansoff (1965), Normann (1976), Mintzberg (1979), Porter (1980, 1985, and 1990), and Freeman (1984).[95]

3.3.1 *Strategos*: The art - the logic - of the general

The concept of strategy is rooted in the military. The original Greek term - *strategos* - first referred to the role of a general in command of an army.[96] Later, it came to mean the *art* of the general; first, his *leadership related* skills and, later, by the time of Pericles (450 BC), his *management related* skills. By the time of Alexander the Great (356-323 BC) the term had come to refer to the skill of *"employing forces to overcome opposition and to create a unified system of global governance"*.[97] Hence, *strategy* can be traced down to dealing with how to win a war, whereas, *tactics* to dealing with how to win a particular battle. Corporate strategy, as opposed to business strategy, concerns the selection of what business to be in, *to begin with*, as opposed to how to function within the business selected. (Quinn, Mintzberg, and James 1988: 1-2.)

Once introduced and applied as a concept to economic sciences by Ansoff (1965), strategy has been approached and vastly examined as a concept related to *corporate management*. Consequently, depending upon the point of view, ten (Karlöf 1987, Mintzberg 1990), seven (Näsi 1987), or six (Gilbert, Hartman, Mauriel, and Freeman 1988) different *strategy schools of thought* can be identified. Regardless of their differing lengths, the lists are more similar than different by content. Nevertheless, these approaches reveal that *there are different perspectives* to the conceptualisation of strategy (Näsi 1991: 30-31.)

Building on Gilbert, Hartman, Mauriel, and Freeman (1988), who conclude that a strategy is "a set of important decisions derived from a *systematic* decision-making process conducted at the highest levels of an organisation", Näsi (1991: 31) defines strategy as *"the plot of the firm's action, the string that pulls together the events."* Näsi (1991) objects the use of the word "systematic", because

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95 Towards the end of the project, conceptual contributions from within the JYU (Myllykangas 1997, Näsi 1999, Laine 2000, and Wahlgrén 2000), were of increasing value.

96 In the context of venture capital, nothing would be better suited. *General Doriot*, the father of classic venture capital (Bygrave and Timmons 1992), was a World War II general.

97 Original source referred to by Quinn, Mintzberg, and James (1988) is Evered (1980: 3).

of its strong association with a formal planning process outside which "many good, practical strategies are born." While this study subscribes to Näsi's conceptualisation, it is important to visit the building blocks of the subscription.

From product-market decisions to defining core competence

After World War II, a key challenge of the industry was to produce things more and faster. The destruction of war had created new markets and demand, and economics of scale was a working solution. By the mid-1950s decline in demand, increased competition, substitute production, and foreign threats were confronted which could not be tackled by the existing management techniques. Research followed demand. The first systematic exposition of corporate strategy, Ansoff (1965), offers a strategy tool *encouraging expansion and diversification*. Following the oil crisis of the 1970s and the emerging realisation of environmental limits of growth, the past two decades have permanently changed the challenge of the industry towards *efficiency, profitability, and focus*. Again, research has followed demand. As for the venture capital industry, which is still in the 'things more and faster' mode, research has not been precursory either. Certain schools of thought can be pointed out, however, as could be derived from chapters 2.1 and 3.1. Interestingly, none of them is dealing with how the generals of venture capital could *employ forces to overcome opposition and to create a unified system of global governance*.

In seeking to address their business concept Ansoff (1965) found companies identifiable by the characteristics of their *product line* (transistor companies, automobile companies), by the underlining *technology* (steel companies, glass companies), and by *markets served*. He anchored the strategy concept to *fulfilling a mission through product-market decisions that create competitive advantage*. The 'Ansoff window' presents a choice between current vs. expanded product line and current vs. expanded markets.[98] *The Product Portfolio* approach, copyrighted by the Boston Consulting Group in 1970, perhaps unintentionally paved way for increased corporate diversification, and eventually developed into a guideline of building and managing multi-business conglomerates. Represented by the famous two-by-two 'Boston Matrix' (or 'Zoo'), composed of star, question mark, cash-cow and dog performers, the BCG approach entertains four basic strategies for portfolio items (be they products or entire business areas): *Build, hold, harvest, or withdraw* (Abell and Hammond 1988).

Normann (1976) could be said to have brought people, the leadership questions, into the strategy equation by 'attaching' *organisation* (a company's way to operate) to Ansoff's product-market window. In the 'business idea' approach a *system of dominance* (of kin to competitive advantage) results for a fit between organisation, product, and market related decisions. The 'business

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98 Näsi (1987: 73) inserts a new column and a new row to the Ansoff window, those of *condensed* products and markets. Up-dated to encourage focus - the opposite of diversification - the classic tool remains relevant.

idea' approach is a simplistic, yet comprehensive approach to describe and analyse a business enterprise - or any organisation with a mission to accomplish.[99]

From competitive positioning to stakeholderism

Porter (1980, 1985) enriched strategy thinking towards the notions of *competition* analysis and the importance of *strategic positioning* – not only relative to existing industry players, but to new entrants as well as substitute-providers. Unintentionally, perhaps, Porter shifted management attention towards the importance of *stakeholders* in corporate strategy. Porter's five forces of industry competition - the classic framework - has been found perfectly applicable to venture capital context (Bruno 1986), and this lead will be followed in the present study. Porter (1990) highlights the role of the national operating environment in the formation of competitive advantage. In venture capital, particularly, operating environment has been identified as a strong such determinant (see, e.g., Bannock Consulting 1998). In its synthesis of the micro and macro perspectives, Porter's thinking provides valuable insight when putting together a theoretical framework of strategy issues related to venture capitalism.

Freeman (1984) can be said to have 'commercialised' stakeholder thinking. A close relative to stakeholder thinking is the concept of corporate social responsibility. Carroll (1989: 52) saw signs that the body of investors sensitive to business's social, ethical, and financial performance was growing, that an ethical investment movement was flourishing. Before gaining ground on the new continent, stakeholder thinking had been part of the Scandinavian corporate strategy infrastructure for some 20 years already; having in fact constituted *an alternative theory of the firm* (Näsi 1995)[100]. A fraction of stakeholder thinkers is of the opinion that the firm should not be thought of as owned *merely* by its shareholders but, due to their significant contributions, by *the other stakeholder groups as well.* Over the past five years or so this perspective or strategy school of thought has taken important steps of development (see, e.g., Wheeler and Sillanpää 1997).[101]

As is evident from chapter 3.2, this study represents the world-view that the efficient functioning of a free enterprise system can only be based on the 'serving one purpose' principle; that defined by company *owners.* Stakeholders

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99 Besides Sweden, the 'business idea' approach achieved a notable position as a corporate strategy tool in Finland, refined towards practical uses by local contributors (see, e.g., Jahnukainen, Junnelius and Sonkin 1980). For an example of early theoretical application of the approach in America, see Galbraith (1982).

100 Rhenman (1964) and Rhenman and Stymne (1965) created a *stakeholder theory* which, in fact, was quite dominant in university management teaching until the early 1980s throughout Scandinavia (Näsi 1995).

101 In the context of venture capital - perhaps the hardest core of the free enterprise system - this view could be said to have been *voluntarily accepted,* if judged only from the dominating perspectives on the venture capital phenomenon (see chapters 2.1 and 3.1). The thesis herein is, however, that this is the case only as long as such attention best serves the interests of the venture capitalists (owners of the venture capital companies).

(including investors) and owners *together* make sure that only healthy purposes survive. Nevertheless, the rise of stakeholder thinking underlines the increased complexity of corporate management and, hence, the ever greater challenge for corporate strategy research and theory-building to be of guide value. [102]

Back to the general

Throughout his work, Mintzberg has widened our understanding of the strategy concept, made it more human - both in good and bad - by underlining how *individuals* differ in their *conceptualisation* thereof. Starting from his seminal work on the roles of the manager (Mintzberg 1973), where he studied what managers actually do, Mintzberg has been bringing the 'generals back to the strategy arena' by underlining the importance of *individuals* to strategy making. It is all in individuals' in-built logic of action and behaviour.

Quinn (1978) quotes an interview where a strategist explains how he, at a younger age, depicted a secret room where all strategic concepts were worked out for the whole company, only to realise later that he never found such a room. Quinn identifies *an incremental logic* behind strategy: "The processes used to arrive at the total strategy are typically fragmented, evolutionary, and largely intuitive."

Näsi (1999) proposes a three-fold framework for strategy concepts: Norm, humane, and logic concepts (summarised in figure 18). Of these, the logic concepts are defined and illustrated as the newest group of concepts in strategic thinking.[103]

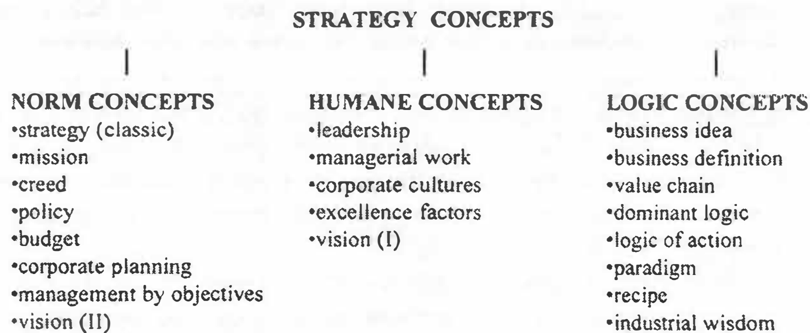

FIGURE 18 Strategy concepts (Näsi 1999)

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[102] The standing of this thesis should not be misread. Social responsibility and recognition of stakeholder interests are vital for the future of a functioning market economy, but so are owners of businesses, and economic focus. Social values should not be *forced* on business from the outside. The rationing has to grow from the recognition that *sophisticated owners* are needed to protect corporations from short-term financial-gain driven *investors.*

[103] The framework provides a non-categorical outline of the concepts. Whereas some logic concepts may be in part normative, others may belong to all three types of concept in a specific company context (for instance, vision can be understood both as a norm and a humane concept).

According to Näsi (1999), the first popular logic concepts - the 'business idea' approach by Normann (1976) and the 'business definition' approach by Abell (1980) – tried to analyse firms against certain (three-dimensional) frameworks. Whereas 'logic of action' by Karpik (1981), seeking to make sense of the rationale behind the collective management action, is acknowledged as the oldest *explicit* logic concept, 'dominant logic' by Prahalad and Bettis (1986) is acknowledged as (perhaps) the most *popular* logic concept. Not all logic concepts wear the *implicit* label of logic even today; paradigm and recipe included (for a recently completed conceptual contribution herein, see Laine 2000).

In their search for a logic for strategy (as a concept) Gilbert, Hartman, Mauriel, and Freeman (1988: 6) address three principles: (i) *persons*: A strategy must provide for the intentional actions of person who devise and act on a strategy; (ii) *business basics*: A strategy framework must pay attention to business fundamentals (such as organisation, competitiveness, and stakeholders); (iii) *timely action*: A strategy must allow management to make timely decisions and to act decisively.

In no conflict with the above principles Näsi, Laine, and Laine (1996) define the concept of *strategy logic* as follows:

> "Our strategy logic is relative to the planning concept, a well-thought-out guideline for decision making, but only a relative. It does not, namely, concentrate on the formal execution of the planning process but tries to perceive and list the unique ideas which are the real key principles in a certain enterprise... In addition, our article likes to see strategy as a perspective, 'a way to perceive the world' both as a conceptual and empirical phenomenon. The strategy logic of an enterprise dictates what is to be done. Its nature remains relatively constant, and it changes and develops incrementally, piece by piece. It includes dominating ideas and principles according to which marketing/product decisions, acquisitions, mergers, divestments and investments, for example, are made."

Having evolved from an Ansoff (1965) planning school of thought - where strategy lived its own *systematic* life, carefully documented - to the synthesising, 'strategist' views entertained by, e.g., Mintzberg and Näsi, the field can be seen to have emerged from a fraction within the classic management discipline to an independent, rich field of research living in close interaction with the generals of modern corporations. Time will tell whether the day ever comes when "the concept of strategy will have outlived its usefulness just like chewing gum... so chewed up that it loses its taste and is discarded" (Näsi 1991).

Anchoring into a strategy logic perspective

Venture capitalists are, by definition, masters of business evaluation. Since the seminal research by Tyebjee and Bruno (1981, 1984), their investment evaluation criteria has been condensable to evaluation of *management*, *product*, and *market* of the target company (see also MacMillan, Siegel and Narasimha 1985). Theoretically, these findings are of close kin to the 'business idea' approach, where a company's business is analysed against a three-dimensional framework

composed of (1) organisation, structure, resources, and organised knowledge, (2) the product system, and (3) niche or market segment (Normann, 1976: 31). The notion of the linkage is supported by Galbraith's (1982: 64) viewpoint: "A 'business idea' is a formula for making money." Merging the venture capitalists' primary evaluation criteria and the 'business idea' view of Normann (1976) as the theoretical research tool to analyse the business of venture capital companies was first reported in Seppä and Näsi (1991).[104]

Whereas the 'business idea' is an early logic concept, venture capitalists can be seen as the forefathers of its practical application in that they - under the conceptualisation followed herein - evaluate the soundness of the *strategy logic* of the investee candidates.[105] The 'business idea' approach has served as the strategy conceptualisation of this research process since its launch in 1987. In the figure below, the ownership framework is merged with the strategy conceptualisation of the study. In figure 19, the ownership framework is inserted inside the 'business idea' framework resulting in the *ownership-strategy framework* of the venture capital firm.

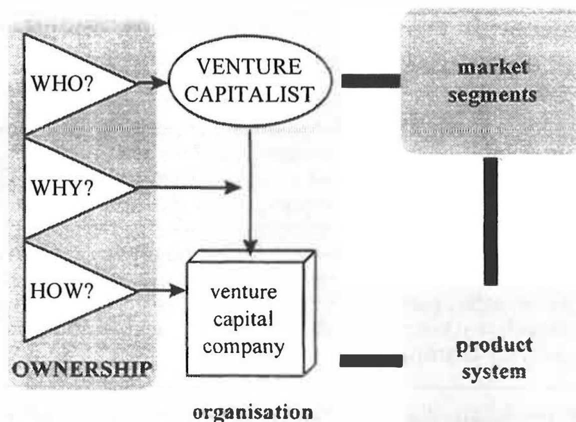

FIGURE 19 The ownership-strategy framework of the venture capital company

Veranen (1987), the seminal corporate ownership study on the Finnish arena, is founded on this same basic approach. He emphasises the importance of understanding that this is a valid approach only if the context of the company's environment, or "industry logic" is taken into consideration. In his view, 'business idea' can be thought of as the mechanism by which a company integrates itself with its environment. A functioning 'business idea' reads into to the "rules of the game" of how to succeed in a given industry (Veranen 1987: 20).

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104 The rationing, herein, is supported by Sandberg (1988: 26) to whom the venture capitalists' track record justifies using key factors in their criteria as an indication of where to focus also scholarly research.

105 The strategy logic of venture capitalists themselves - what they, in fact, produce, how, and to whom - has not been that extensively addressed.

The generals of today

History has chapters of its own for 'generals-turned-emperors'; and it may be realistic to assume that *military coups* will take place in parts of the world, also even after year 2000. But history also has leafs for 'CEOs-turned-emperors'. In fact, stories of *corporate coups* are a much more recent phenomenon – at peak as recently as the 1980s.

As a result of the irreversibly progressing securitisation of corporate ownership and exponentially growing capital markets – which only accelerated in the past decade worldwide – corporate strategy reality is very different in 2000 than it was in 1987, when this research project was inaugurated. Already well before 1987, this development had created new 'investorial' professions – in addition to 'managerial' ones – in the analysis and evaluation of publicly-held corporations and the buying and selling of their securities. As discussed in chapter 3.2, at a point in time, investors could protest against poor management – fight corporate coups – practically only by selling their shares. The fact that venture capital companies, unexpectedly from various stakeholder perspectives, discovered this *arbitrage opportunity* in the 1980s and started to tailor fund vehicles for take-overs of such poorly-managed and hence undervalued companies, created the notion of *owners back in business*. Venture capitalists are hence looked at, in this study, as owners rather than investors or managers. In this sense, the definition of the present study to *strategos* takes the form: The art (the strategy logic) of the owner.

Ansoff's (1988) *New corporate strategy*, insightfully acknowledges the "re-emergence of entrepreneurial behaviour" laying out a theory for organisational change from competitive ('old strategy') to entrepreneurial ('new strategy') mode of operation. Ansoff's rationing has served as one important ingredient in the formulation of the theory proposal set forth in this study. Ansoff (1988: 3) quotes Alfred P. Sloan Jr:

> "The strategic aim of a business [is] to earn a return on capital, and if in any particular case the return in the long run is not satisfactory, then the deficiency should be corrected or the activity abandoned for a more favourable one."

In this study, strategy is understood as the corporate managers' choices (thinking, decisions, and action) in order to fulfil their company's mission. Mission is understood as the corporate owners' choices defining the rationale or purpose for a company's existence. Backwards, a company exists for a reason – a mission – set by the owners at company foundation, and checked and potentially changed by them, over time. The managers' core task is fulfilling the mission under the framework (resources and company legal structure) provided by the owners. Managers' choices concerning the company's organisation and product-market decisions comprise its strategy. The owners lay the foundation for strategy logic.

3.3.2 Organisation: Company's way to operate

> "People run organisations - studies do not. Yet despite this simple truth, major corporations in recent years have relied on "strategic" planning techniques for setting company direction. These unwieldy, complex systems are based on quantitative analyses of markets and competition... Organisations run by systems have been known to misjudge the marketplace or acquire companies unrelated to their own business concept. The result has been misallocation of resources and substantial financial loss." (Robert 1988: 7)

Venture capital activity can be characterised as organisationally lean and economically significant *decision-making* concerning the life of private or to-be-private business enterprises. In very few industries such a relative importance is placed on such a small number of individual decision-makers. Hence, it is difficult to think of venture capital organisations as faceless institutions where decisions are mechanically processed. However, venture capital is pooled into and managed by a *diversity* of organisational and legal structures. Whatever diversity prevails in a given economy at a given time, that particular diversity is responsible for the oversight of the market exchange system of the given economy.

Thinking of *capital* as the *muscle* of venture capitalism; the *venture capital process* as its *blood* circulation system; the *corporate structure* as the *skeleton* within; and the *ownership* of a venture capital company as the *heart* of venture capitalism: The *organisation* of a venture capital company can be depicted as its *brain*.[106] As the venture capitalist is depicted as the owner of control of a venture capital company, in this study he symbolises, by definition, the heart of the phenomenon. Is he also the brain, is a question related to his role in the company. If the venture capitalist is a legal person not owned by the venture capital firm's operative management, the heart and the brain are separate from each other. On the other hand, if the venture capital company is owner-managed, then, by definition, the venture capitalist symbolises both the heart and the brain.

As was elaborated above, venture capitalists come with a multitude of faces - some being 'faceless' altogether. Some organisations are run by owners (partners) themselves. Some are run by hired management monitored by representatives appointed by trustees of institutional shareholders. Nevertheless, the size of a typical venture capital organisation is very small, often no more than three to five managers and one to three staff members; extremely seldom over ten individuals. According to the industry survey conducted in both America and Finland (in 1992), ca. 68% of the American respondents and 84% of the Finnish respondents comprised of organisations of less than seven people (see chapter 5.1 for more).

In the following, the organisation of the venture capital company will be addressed separately for the case of a single LTD structure and the case where limited-life LP fund-vehicles are utilised by the venture capitalist. As discussed in chapter 1.3 already, the latter structure is better suited for the owner-

[106] Idea for the analogy borrowed from Mintzberg (1979).

manager venture capitalist. In fact, as pointed out, the use of a single LTD structure might - particularly if becomes publicly-held - *unintentionally* lead to a situation where an entrepreneurial venture capitalist is changed to an institutional venture capitalist; either as a result of fund-raising related dilution of the owner-managers' shareholding or simply due to trade of existing shares.

Organisation of a venture capital company utilising the LP fund structure

In the view and experience behind this study, the *food* or fuel that controls the moves - energy and dynamism - of the 'character' depicted above is, in a word, *incentive*. This of course concerns *direct financial* incentive, but not only. It also has to do with an *indirect strategic* incentive. Which, in turn, has to do with where the individuals of the organisation are physically heading (nowhere vs. still higher in a hierarchy) and other issues closely related to *organisational culture*. Companies that utilise the LP fund structure are typically management-owned, but not always. Addressing management-owned venture capital firms, Sahlman (1990) describes how staff members "function as apprentices to the general partners and often become general partners themselves in later funds."

For an owner-managed venture capital company utilising the LP fund structure, the funders are not *shareholders* of their business. They own claims referred to as limited partners' units in (separate) LP fund vehicles. From the agency theory perspective, however, general partners are the agents of the limited partners. In the view of this study, general partners *own the control* and hence are not depicted as agents in the classic sense of the word. Conversely, the funders are *not* seen as the principals of the venture capitalist in this setting. They are seen as just another stakeholder of the venture capitalist with a clear claim on the firm, similar in nature to the claims of debtors and suppliers of a business. They have exchanged a resource with the venture capitalist, but not become his principal (because they *do not own control*). This is where the present study differs - semantically, if you will - from Sahlman (1990). However, many of the conflicts of interest between a venture capitalist and the funders of his various funds under management reported by Sahlman (1990) are considered extremely relevant herein: It is in the interest of the funders to *contractually* limit the operational freedom of the venture capitalist in managing parallel funds, raising additional funds, engaging in diverging businesses (such as self-dealing or corporate finance).[107]

In America, venture capital companies utilising the LP fund structure are often established partnerships (not corporations) themselves; and the individual partners themselves often operate as direct general partners of the fund vehicles. If the venture capital company is formed as a corporation, it is not extraordinary for the partners individually or their joint corporation to act as general partners. In Finland, for example, to the knowledge behind this study, no individual has personally acted as a general partner of an LP fund vehicle,

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[107] Limited-life being one such measure: "The venture capitalist cannot keep the money forever" (Sahlman 1990).

which - apparently - is typical of Europe in general. Nevertheless, Sahlman (1990) vividly presents how the financial incentive of the individual venture capitalist (acting as a general partner directly or via corporation) aligns his and the funders' limited partner interests. A venture capital company utilising the LP fund structure *typically* contributes 1% of a fund's capitalisation. It charges the funds for a management fee, typically 2.5% of the fund's committed capital on an annual basis. It also becomes contractually entitled to 15-30% carried interest (share of the profit of the fund), payable once the principal (often topped with a fixed *hurdle* rate) has become fully disbursed to the funders.

Figure 20 illustrates the making of a venture capital company utilising the LP fund structure. Typically, such a firm is owner-managed supported by an apprenticeship culture - both aspects that serve to minimise the turnover of personnel.

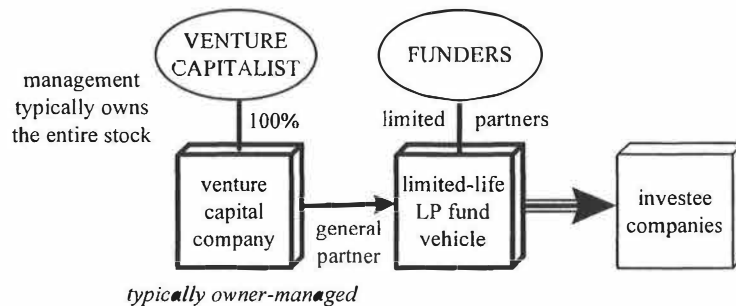

FIGURE 20 The making of a venture capital company utilising the LP fund structure

Organisation of a venture capital company utilising the single LTD structure

This is a company typically owned by outside shareholders and run by hired managers. Because the funders herein are, by definition, shareholders (along with the venture capitalist), efforts to identify the venture capitalist sometimes remain theoretical, at best. For example, it is difficult to define the venture capitalist in a publicly-held venture capital company with more than one hundred shareholders none of which owns more than five percent of equity. Which group of shareholders should be referred to as the venture capitalist and which as funders? Figure 21 depicts the making of a single LTD structure.

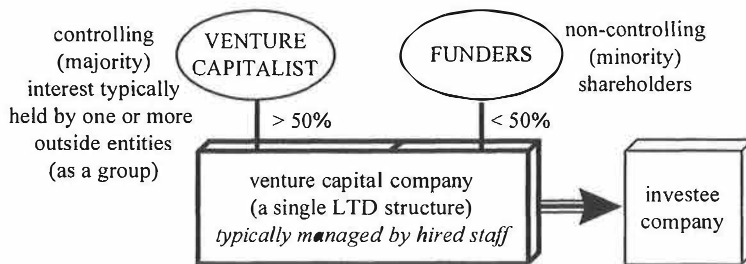

FIGURE 21 The making of a venture capital company utilising the single LTD structure

In both cases (figures 20 and 21), a number of individuals come up with an enterprising idea and assemble to establish both a corporate and an organisational structure for its fulfilment. Sometimes, the process is led by independent businessmen who (combined) assume the controlling interest over the business and become personally involved as managers of the firm. Sometimes, the process is led by agents of established entities or by private investors who will not engage in management. Regardless of the way, *operating-environment embedded* strategies will eventually start to influence the organisation, and the organisation starts to influence its owners - even the development of the ownership base and the corporate mission. Koski (1988: 140-144) concludes his insightful dissertation on ownership strategy and competitive advantage into a set of normative hypotheses. According to his first proposition:

> "Corporate management can create a new dimension of competitive advantage via ownership strategy by planning the ownership structure in such a way that the owners'/investors' behaviour-driven investment strategies are compatible with the business strategies and the organisational strategies designed to create competitive advantage. New investors - especially foreign investors - can influence the overall investment criteria of the total owner/investor group. As a result, they can have an impact on corporate strategy by affecting corporate management's capability to restructure and its power to make decisions. Corporate management must, therefore, plan ownership strategy in such a way as to ensure (i) the matching of the ownership portfolio with the business portfolio, and (ii) the matching of ownership structure with business dynamics."

The challenge of the venture capitalist is to create an organisation and a corporate structure that neither diverge ownership from strategy nor *vice versa*. Largely, this culminates in the roles of management and funders in the ownership of the venture capital company.

> "Our position is very clear. The organisation structure should support the strategic profile and not vice-versa. Again, our work shows that there is no ideal organisational form. The key element is the driving force. A product-driven company should not be structured like a market-driven company. Each one's corporate behaviour is different and the structure should reflect this. The structure of each should be such that it supports and promotes the direction of the corporate entity." (Robert 1988: 94).

In his analysis of the *LBO association*, which according to Sahlman (1990) resembles a *venture capital company* to a large extent (and which herein are seen as parts of the *same* phenomenon), Jensen (1989a, 1989b) goes as far as seeing this basic setting (illustrated in figure 20) as an alternative structural form to the large corporation. Daems (1978: 34), who studied Belgian holding companies as *ownership vehicles*, compares the organisation of a *financial* holding company and an *industrial* conglomerate as follows:

> "The conglomerate pursues a fairly well-defined corporate policy through a divisional organisation. The subsidiaries are managed as a division by the corporate headquarters, which uses formal and standardised reporting mechanisms and uniform control systems to implement corporate policy and to evaluate divisional performance. The holding company conducts an ill-defined corporate policy through a loose organisation, which might be too flattering a term to describe the real system... There is nothing in the holding company comparable to the staff functions of the conglomerate's head office."

Using Robert's (1988) typology (table 6), each venture capital firm would like to be an 'A company': Running well operatively based on good strategising (as all companies in every industry), but many may - after all - fall into either B, C, or D category (C being the 'Rock' category).[108] In chapters 4-6, linkages between ownership and strategy of venture capital companies are addressed empirically.

TABLE 6 Typology of *good* versus *bad* strategic and operational competence

	'GOOD' STRATEGY	'BAD' STRATEGY
'GOOD' OPERATIONS	A (explicit strategic vision, operationally competent)	B (uncertain strategic vision, operationally competent)
'BAD' OPERATIONS	C (explicit strategic vision, operationally incompetent)	D (uncertain strategic vision, operationally incompetent)

3.3.3 Product-market decisions: Supply meets demand

What is the business of a venture capital company? Depending on who ask, you will get a different definition. Ask entrepreneurs and they will say venture capital is *financing*. Ask investors and they will say it is a *financial instrument*. Ask governments and they will say it is an *economic mechanism* to create jobs. Venture capitalists are happy with each of the above but often have, on the top, a view of their own. Sometimes a different view of the business is presented to different stakeholder groups.

The strategy of a venture capital company has not been extensively addressed in the public. Typically, the *investment criteria* of a given venture

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108 In the words of Rock (1987): "Strategy is easy, but tactics - the day-to-day and month-to-month decisions required to manage a business - are hard."

capital firm is regarded as its strategy. To-date, venture capitalists themselves have been happy with the *status quo*. In 1990, the issue of strategy was raised for the first time as a panel discussion topic at the annual Venture Forum conference by Venture Economics, Inc. (see conferences attended, appendix 2). The audience asked the venture capitalists to define what is the product and who is the customer in venture capital. First, what is the product?

> Venture capitalist C: "There are some people who have made money, as 'venture capitalist' without money to invest, but very few. Most venture capitalists... when we talk about the venture capital process, it starts with fund raising. And some people fund raise by making or inheriting money. Some people fund raise by going to friends, some people go to institutions, and so the fund raising is an important element from our perspective in the venture capital process, per se, and therefore your product really is, one, money. However, if money was your only product, then the institutions would not need the venture capitalist to invest that. They would go direct and there would not be the persons and the guys the venture capitalists working with the entrepreneurs. And so our product is: Money. But it is incomplete there - it is coupled with the ability to work with entrepreneurs to build businesses, and as a result of that you do what ever you need to do. Some firms provide great technical advise, some firms have great market positioning. Some firms are excellent in terms of financial structuring of a transaction. And so different firms have different elements of the product they provide with money, but if money alone was the product then the limited partners would not need a venture capitalist to go between them and the entrepreneur."

What, then, is the market (who is the customer) of a venture capital company?

> Venture capitalist D: "... But I think if you really were pressed against the wall and had to answer the question honestly of ranking the three, in our view, our investors come first - we are fiduciaries, we can not ignore that responsibility not matter how improved we get with our investments - second is the entrepreneurs we sponsor, and I think third and close third is our investment partners because we are in a long term relationship business."

> Venture capitalist C: "... If we believe that we are in the business of building businesses, and achieving high rates of return are by-product of doing that well, then we think that the portfolio company or the entrepreneur is the customer and that we ought to be able to develop delivery systems, if you will, to better serve that portfolio company in building a business. If we are successful in building businesses with rates of return as by-products, limited partners will be available for us. However, in order not to insult our very valuable limited partners, we have come up with to separate words: One is a customer which is our portfolio company, the other is a client, which is our limited partner. We think that if you look at a lot of firms they actually have a couple of different customer constituencies and I think venture capital business is very similar. Limited partners are very important clients of our services, however, the customer who we build our business to develop is the portfolio company."

> Venture capitalist E: "... One of the things that we have learned and observed in the industry is that building businesses is part of our strategy. As you can build businesses and not make money for your limited partners, and that is really discouraging. So if you have as your orientation that your limited partner is who you are managing the money for, then what happens is in the course of building businesses you build them differently: You provide capital differently you look for corporate partners more aggressively you help to establish a culture, at the company, where they don't spend money, in order that

> when the business is built there is a return. So, we actually have used both terms, client and customer, believe it or not they are applied to the same constituency."

Venture capitalists - chosen and prepared to discuss strategy issues at a major industry conference - are not necessarily themselves at ease about the most profound elements of their strategy world. Due to the industry's rapid growth and transformation many of the industry's players are at different stages of development. In the words of Galbraith (1983), venture capital companies *not only* locate differently in relation to the *natural sequences* of the venture capital industry, but also in relation to the *transformation* of the sequences.

In this study, venture capitalists are seen as owners rather than financiers. Normatively, then, venture capitalists *buy* stakes in investees - more than sell financing to them. They acquire raw material for their shareholder-value factory. At the end of the day, a venture capitalist's true market is comprised by the buyers purchasing the divestees. There is no doubt that most venture capital companies exist without giving this very perspective much, if any, thought. Some, in fact, take consistently differing stands as illustrated above. Hence, the study does not stem from the reality as *communicated by majority of individuals* involved with the phenomenon. Instead, it stems from how *some individuals truly perceive* reality. The study aims at better understanding venture capitalism by linking the research to general developments in the market for corporate control and by disclosing and discussing aspects related to venture capital companies that have remained hidden for so long.

According to the classic definition, a venture capitalist makes patient investments in minority stakes of entrepreneur-driven, early-stage, new-technology based ventures, adds value hands-on, and, eventually, is to fulfil his mission via profitable exits.

According to Bygrave (1989: 143), the venture capital process brings together three primary stakeholder groups: *Funders* (limited partners) who send funds to venture capital companies, *venture capitalists* (general partners) who channel the funds to portfolio companies, and entrepreneurs who offer the best investment opportunities, referred to as *suppliers*, in this study. Bygrave (1989) concludes that both investors and venture capitalists "have an incentive to invest in new ventures that have the greatest potential to go public." This study brings in a *fourth* primary stakeholder to the equation: The investors who buy portfolio holdings from the venture capitalists, referred to as *consumers* (see figure 22). [109]

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[109] Government is the *next* primary stakeholder (in line) to be brought in.

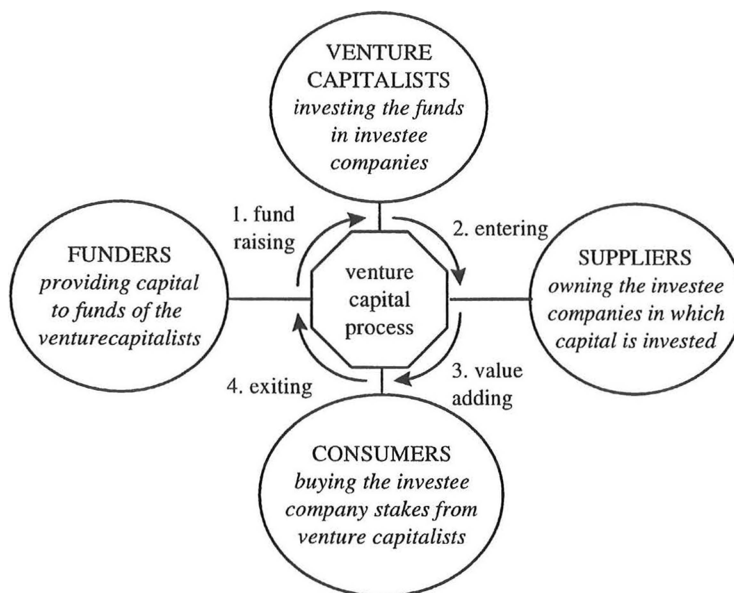

FIGURE 22 Stakeholders of the venture capital process (Bygrave 1989 amended)

3.4 Looking at the stages of the venture capital process through the 'ownership-strategy' window of a venture capital company

> "A final stereotype that has entered [venture capital] industry folklore is that the investing process itself operates as a highly organised, rational, and methodical model of modern financial engineering." (Bygrave and Timmons, 1992: 10).

Since its commercialisation by wealthy individuals in post-war America in the 1940's, venture capital has become established both as an industry and as an emerging field of research. During the first half century of the industry's life, the analysis thereof has become anchored around the venture capital process, compressible into four main stages: *Fund raising, entering, value adding,* and *exiting* (see figure 10 for an illustration). The stages follow each other chronologically in each investment. Typically, however, a venture capital company manages several parallel investments, each at a different predominant stage.

Each of the four main stages can be divided into two or more stages. In their seminal study on the venture capitalists' activities, Tyebjee and Bruno (1981, 1984) end up dividing the venture capital process as follows: (1) Raising money to invest, (2) locating potential investments, (3) screening potential investments, (4) evaluating potential investments, (5) structuring investment agreements, (6 a) assisting and monitoring ventures, (6 b) exiting.

It is noteworthy that, in many of the illustrations of the venture capital process *entering* is the stage most often presented as two or more different stages (such as Tyebjee and Bruno 1984), instead of depicting it as one stage.[110] The fact that entering is considered to represent only one stage in this study is not meant to signal that it is perceived bit less important, on *absolute* terms, than in earlier studies, but merely to analyse its *relative* importance to the process as a whole. In this study, venture capitalism is examined as a process of *buying, developing, and selling* ownership interests in selected enterprises, and as the *financing* thereof.

Next, in this chapter, the four stages of the venture capital process are addressed, one-by-one, from the perspective of a start-up venture capital company. The 'business idea' approach is applied to each stage, i.e., each stage of the venture capital process is seen as another development stage of a start-up. Galbraith (1982: 64-65, 81) noted that "the business idea of a venture does not emerge to full blown at the outset. Pieces of it are tested as the venture moves through stages." In his view "it is primarily the market and organisational issues that limit the growth of ventures and explain much of the observed performance... If the managers know the stages, the appropriate organisation and transition issues, they can more easily decide and implement the organisation that they need." In the words of Kierulff (1986: 148): "Reorganisation is sometimes the only constant the entrepreneur and the venture capitalist can count on for the first few years."

As encouraged by Jemison (1991) this study is marked by a 'marketing oriented drive'; the marketing functions of venture capital companies will be examined. Tyebjee, Bruno, and McIntyre (1983) discover that fast-growing high-technology companies' go through a four-stage marketing development process. Although venture capital companies are different businesses in many ways, some of their basic notions have proved worthwhile in the make-up of this investigation.[111]

3.4.1 Fund raising: Getting business plans funded?

If one wishes to start up a venture capital company and is not a wealthy individual, he is destined to start from square one: He needs to raise start-up funding like any other entrepreneur. Established venture capitalists require full-fledged business plans from their investee candidates - and sharp plans for any follow-on investments as well. Venture capitalists do not get away with anything less in their own fund raising, either. Nonetheless, the reference to similarities in fund raising by entrepreneurs and by venture capitalists has not been made previously.

For every venture capitalist who wants or needs to leverage his business, fund raising begins from setting up a venture capital company, and getting

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110 Davis (1986) depicts the venture capital process comprising four stages: Screening of investments, agreement on principal terms, due diligence, and approval of investment.

111 Technically or visually, the construction of the framework of venture capitalist strategy logic, as well as the archetypes thereof, can be seen influenced by Mintzberg (1983, 1989).

organised for action. For the established venture capitalist, fund raising begins from the drafting of a new prospectus for a new fund vehicle. Herein, we work on the assumption that an LTD structured venture capital firm is established to utilise the LP fund structure.

Typically of venture capital companies utilising the LP structure, each of their fund vehicles has a strictly focused investment strategy. A very large venture capital company can have specific 'divisions' for differently focused funds - some that are country or market specific, some that are industry or sector specific, and some that are early or late stage specific. For an example related to the complexity of fund vehicles as financial instruments, underlining their nature as part of the product system of the venture capitalist, see Morris (1983).

Fund raising entails much more than merely selling a financial instrument to investors. On the other hand, decisions concerning the sale are not trivial or standard, either. A venture capitalist has to decide whether to use a placing agent (e.g., an investment bank) and whether to offer the vehicle internationally - to list only two considerations. Figure 23 illustrates how the fund raising stage integrates funders into the business of the venture capitalist. At this stage of the venture capital process it appears that the fund vehicle is the venture capitalist's product and the funders are his customer.

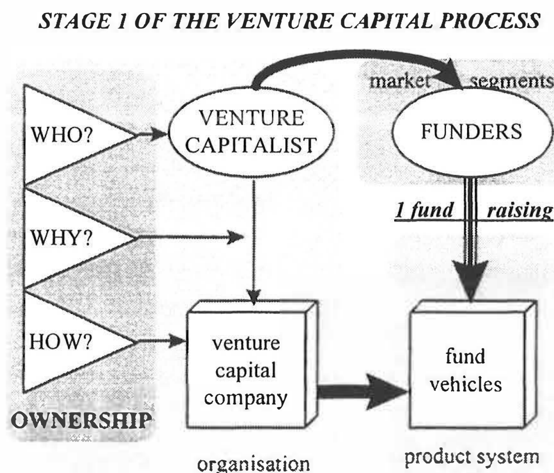

FIGURE 23 Fund raising stage and the steps preceding

Perhaps due to the explosion of fund raising activity in the 1990s in both America and Europe, the volumes of capital pooled for venture capital investing have been keenly followed and reported. Some concerns have been raised, though, about the fact that only a fraction of the funds raised has actually become invested. Nevertheless, a notable portion of the research being conducted on venture capital today relates to recording the amounts and sources of funds raised annually on various markets.

The effects of the decisions made in the first stage of the venture capital process on the dynamics of the other stages, and the whole, have not been extensively emphasised in the research conducted to-date. And even though this study concentrates on the venture capital process as a whole, fund-raising related choices enjoy a crucial emphasis in this work. To summarise, fund raising entails:

- a venture capitalist discovering a given window of investment opportunity
- the venture capitalist setting up and organising a venture capital company
- formulation of investment strategy in writing (for a new prospectus)
- tailoring a fund vehicle that fits the strategy as well as funders' preferences
- soliciting the fund vehicle to funders to finance implementation of strategy

3.4.2 Entering: Search for the perfect raw material?

> "So here is the prize-fight ring of venture capital: In one corner, the entrepreneur-inventor, and in the other, the manager of venture capital. The referee is the process used by the venture capitalist in judging whom to bet on and whom not to bet on... The manager of venture capital is getting better in making these investment judgements, but in the final analysis, he makes an intuitive and ad hoc judgement." (Shames 1974: 108.)

Entering is the focal point in the venture capital investing process. After an investment has been made, there is no coming back.[112]

Entering is much more than the investment decision, however. It is a process in itself, starting from the building of a *deal flow that supports the investment strategy* of the fund vehicle. In the case of multiple fund vehicles, each differently focused fund requires a deal flow strategy of its own. If entering was not a two-way-road, creating deal flow would be by-far more difficult a task. The fact that the entrepreneurs' need for venture capital financing quite closely matches the venture capitalists' need to provide such helps. In sophisticated markets, such as America, entrepreneurs can easily educate themselves on the investment criteria used by venture capitalists, and write business plans as expected by them.[113] Regardless, the difference between a funded venture and an unfunded venture is very thin.

> "It's all negotiable. There are no rules of thumb. A lot of it is bluffing, a lot of it is muscling, but the essential truth is, everything is negotiable." Robert B. Metcalfe, founder of venture-backed 3Com Corp. (est. 1979). (Wilson 1986: 177.)

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112 Sometimes, although very rarely, successfully raised venture capital funds are reversed for dissolution before making a single investment. One such case was a fund raised in 1994-1995 by a US based venture capital group for investments in Russia. As entering was not consummated in due time, the fund was prematurely dissolved, and capital returned to the funders.

113 In emerging markets, such as Russia, entering is more of a one-way-road to foreign venture capitalists - much due to difficulties and complexities related to establishing contacts between the venture capitalists and local entrepreneurs and, if such is achieved, they have trouble in communicating business and exchanging (financial) information.

Historically, if not most recently, the entering stage has received more research attention than any of the others.

The dominant role of the entering stage in venture capital reality is understandable given the interest of entrepreneurs to learn of venture capitalists' *investment criteria*, the interest of governments to learn of the *distribution* of invested capital (by sector and corporate development stage), and the interest of the venture capitalists to inform the other two of the same. Besides being the sexiest stage - the one during which the overseers of the market exchange system make their *terminal choices between ventures* seeking for financing - entering is also relatively convenient to address quantitatively and hence to address by scholarly measures.

Bruno (1986) referred to money as the "raw material" of the venture capital industry and, consequently, to funders as the industry's "suppliers." In the view of this study, however, given the developments observed in the industry during the late 1980s - and the philosophy of the classic framework of venture capitalism - funders are not to be conceptually referred to as suppliers. The role of funders as venture capitalists' key customer group began to strengthen in the late 1970s (see chapter 4.1.2.3) and has only grown stronger since. Nevertheless, it is the investee ventures that are - conceptually - depicted as the raw material of the venture capital industry, and the entrepreneurs as its suppliers.

Figure 24 illustrates how entrepreneurs, as the suppliers of a venture capitalist's raw material, become integrated in his business. At this stage, it appears, the fund vehicle (topped with money after successful fund raising) is the product and the suppliers are the customer, to the interaction with whom the venture capitalist now pays the greatest attention.

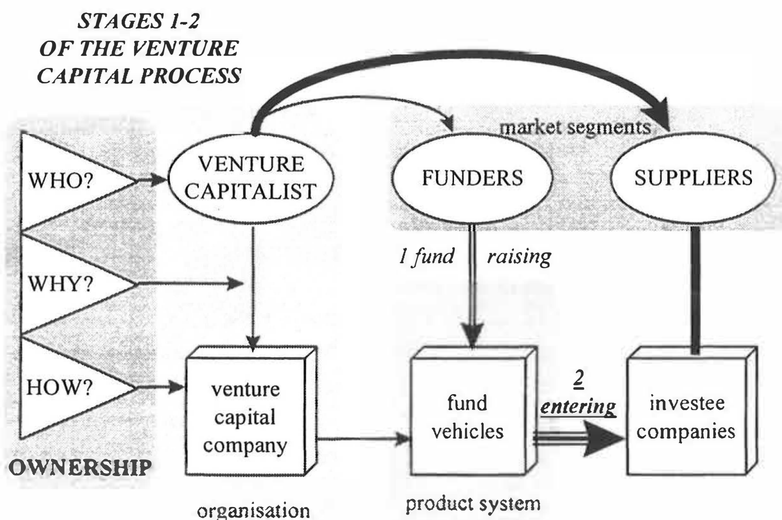

FIGURE 24 Entering: Venture capitalist's search for the perfect raw material

"One man's meat is another man's poison" is an old adage, subscribed to by many venture capitalists. Many will investigate a same venture and come to opposite conclusions. (Timmons 1986: 232.) In the words of Sandberg (1988: 15), "venture capitalists are a diverse group, and their new venture evaluation criteria reflect this diversity. These criteria frequently embody preferences based on the venture's stage of development, its location, its industry or technology, or size the size of the investment required. Venture capitalists have been found to base 24 percent of their rejections on policies that reflect their own interests, knowledge, and so on."

Some authorities have insisted, and still insist today, that an investor securing majority control in his investee companies is not a venture capitalist. For them, only investors making minority investments can be referred to as venture capitalists. What escapes them is the fact that through *syndication* such 'minority investors' often *together* hold the majority in a venture and that even a solo player will typically secure control, via covenants. Also, as pointed out by Bruno and Tyebjee (1986), the entrepreneurs in receipt of venture capital will at some point have to relinquish majority ownership in their companies.

Several entrepreneurs approach venture capitalists each and every day all over the world. The proposed investment opportunities range from rough ideas of new products or services to buyouts of mature companies or parts of conglomerate groups. Whereas a good portion of the contacts screened lead to rough evaluation, not many end up in due diligence. At the end of the day, only a fraction of the proposals become invested in.

During the entering stage, the venture capitalist's job is to evaluate the odds of success of various businesses. This involves significant interaction with entrepreneurs boasting a variety of talent, drive, and persuasion – each trying to convince the venture capitalist of their personal potential, that of their team, and the business. It very much depends on the stage and technology, in which the venture capitalist concentrates on, how important the entrepreneur is to the venture's success. The earlier the stage and the newer the technology the more valuable the entrepreneur, and the more his qualities affect the venture capitalist's decision making. On the other hand, the more hands-on the venture capitalist works with his entrepreneurs, the more risk he is capable of taking in their regard.

The seed and start-up projects have another natural disadvantage against larger, more mature projects, as the cost of observing, monitoring, and controlling the investment is quite similar regardless of the stage or the size of the venture. If anything, it can be argued that more resources are required to monitor seed and start-up ventures than to monitor more mature and established business operations. Hence, later-stage ventures enjoy "economics of scale" unavailable for the early-stage ventures due to much smaller scale in terms of the capital invested.

Figure 25 illustrates the broad perspective on a venture capitalist's investment spectrum (from early to late-stage, from short to long-term investments, from high to low-tech companies, and from minority to majority-stake investing).

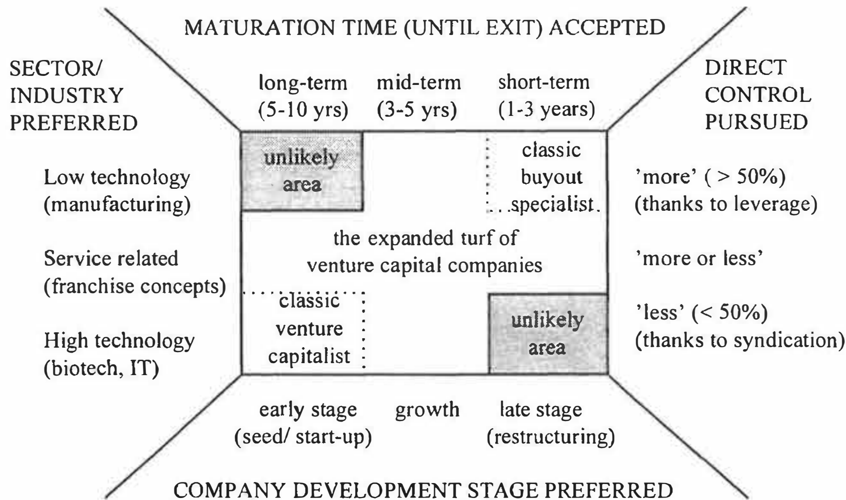

FIGURE 25 Investment spectrum of today's venture capitalists

There is no denying the fact that seed and start-up stages are the most risky stages of a venture's life, and the most difficult ones to manage for a venture capitalist. Most of these ventures are proposed by persons that have no prior experience in building a business, the economic arguments for their ideas remain unproved, and the markets for their products are unknown or dismal to begin with. Additionally, quite so often entrepreneurs do not want to see their ventures fall outside their personal control, which may slow down company growth. As a result, only a limited number of ventures emerge to growth from these stages. Not unexpectedly, the venture capitalists that make such investments require higher expected rates of return on their investment.

The famous venture capitalist Arthur Rock looks for entrepreneurs who ask how they can make their business a success, not how they can make a fortune. He prefers entrepreneurs who want him to participate in decision-making in their companies. "Most entrepreneurs can use all the help they can get in developing and implementing the tactics that will make the successful in the long run." (Rock 1987.)

If venture capitalists are much to be blamed for negative cultural developments, the European entrepreneur does not necessarily stand up to the prerequisites of making successful venture capital investments, either. As the number one thing, the entrepreneur is to realise that a private equity investor requires and deserves high return on his investment in order to offset the risks he shares with the entrepreneur, and to reward his contributions to value adding. In America, the highest investor returns have been earned through initial public offerings (IPO). From the entrepreneur, a successful IPO requires relatively short-term oriented desire for company growth, commitment to releasing public information, expansion of ownership, and transition to professional management.

The stereotype (continental) European entrepreneur desires to build a company for his family - to be passed on to sons and daughters. He wants to be independent, his own boss. He is quite willing to let someone share his risks, but only as long as he does not have to give outsiders a say in his company. He builds long-term economic self-sufficiency seeing his company as a *family person,* rather than fast growth and maximal personal wealth using the company as the *vehicle* to get there. In summary, entering entails:

- deal flow generated in the market as defined in the investment strategy
- investment proposals screened initially for rough matches with strategy
- rough evaluation of screened proposals to pick the greatest potential
- due diligence performed and prospects investigated on hand-picked deals
- investment decisions made and closing negotiations inaugurated

3.4.3 Value-adding: Production of marketable business value?

> "The total value of an investment opportunity may critically depend on the financing terms governing the deal" (Sahlman 1993).

During value-adding a venture capitalist works to enable a maximal margin between the purchase price and the sale price of a given ownership stake. This seems like a simple formula but it is not. The true purchase price is the sigma of the price paid for securities at entry, prices paid for securities upon follow-on investments, and the costs of the governance work conducted throughout the investment period. The sale price is, respectively, the sigma of all payments received in cash and in kind for the securities, when sold, and interests, dividends, and potential management fees received before the final sale.

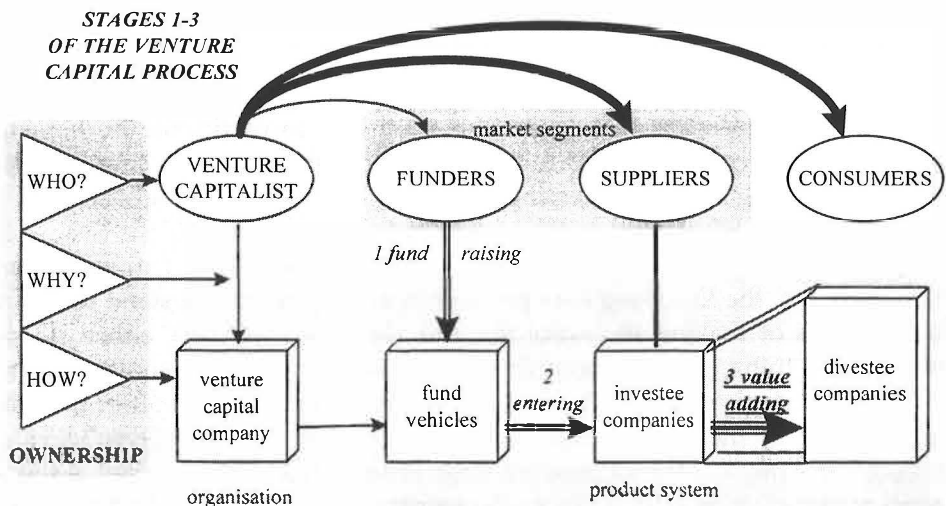

FIGURE 26 Value adding: Venture capitalist at work building business value

Because both the purchase price and the sale price often comprise of several payments that all materialise at a different time, it is fair to claim that calculating the accurate IRR for a single investment - let alone an entire fund - is a great challenge. Nevertheless, the margin is concretely worked on during the value adding stage, and investee ventures are turned into divestee ventures; as illustrated by graphical evolution in figure 26. Value-adding appears to be the stage during which no *primary* marketing tasks are performed towards the outside world; resembling a 'standard' *production process* to a great deal.

For a concise review of venture financing techniques and the underlying philosophy, as presented by a venture capitalist, see Glassmeyer (1983), and for a good overview of issues related to the structuring and pricing of the financing, see Golder (1983), another renowned venture capitalist. For the legal documents related to venture financing, see MacDonald and Testa (1983) - the former a venture capitalist-turned-entrepreneur, the latter a renowned legal counsel of the industry.[114]

There has been a great deal of debate on whether venture capitalists add value. Rosenstein, Bruno, Bygrave, and Taylor (1989), who could not establish convincing evidence thereof, conclude that the "usefulness of outside board members" was perceived highest (by investee CEOs) in monitoring financial performance and serving as a sounding board. These findings are in line with MacMillan, Kulow, Khoylian (1988), a study on value adding activity as reported by *venture capitalists*. The former study could not establish that venture capitalists add more value than other outside board members, however.

Harrison and Mason (1992), in their study on the UK market, discover that informal and formal venture capital investors differ *qualitatively* more than quantitatively in their investee participation. While informal investors seem to believe more in the entrepreneurs, formal investors put more emphasis on the control function. Sapienza, Manigart, and Herron (1992) conclude that venture capitalists in America and the UK are more involved in portfolio companies that those in France and the Netherlands. This is in line with expectations based on national structures of governance (discussed in chapter 3.2.3). Many of the findings referred to above are consistent with Yaworsky and Karger (1979) who conclude that venture capitalists ("badly burned in the sixties") structure their deals so that they have more control and *exercise control for a reason*: "It is not the venturer's desire to control companies, per se, however, the experience of venture capital firms in recent past has shown that had more control been exercised by venturers in losing firms, more could have been salvaged."

Challenging a taboo, it is insisted herein that a venture capitalist adds the most value by striking deals that require no (traditional) value-adding efforts *whatsoever*. Such investments produce tremendous value to *the funders by way of contributing to high ROIs* of total fund performance, to *the entrepreneurs by way of enabling unhindered growth* supported by the right capital structure, and to *the government by way of selecting corporate winners* - performing in their role 'to-the-

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[114] All these papers, plus relevant others, locate in the 1983 edition of the *Pratt's guide to venture capital sources*, a Venture Economics, Inc. publication.

penny' as Brophy's (1986) *overseers of the market exchange system* - and thereby spurring growth and creating new jobs. The thing missing are the efforts *perceived* as value adding. The truth is, however, that hours spent in board rooms and on the factory floors of the portfolio companies are not, *per se*, value adding. More often than not, such efforts are value destruction from the perspectives of both the funders and the government. Namely, the worse the performance of an investee, the more of his time does the venture capitalist have to allocate to its development and, reversed, the better the less.

Says Silver (1985: 250), a venture capitalist's objective is to "protect capital and turn over the investments at higher prices than the fund pays. Venture capitalists get better at this process every time their investments run into serious trouble, but the objective is to avoid the trouble." In their study on what venture capitalists do, Gorman and Sahlman (1989) conclude that the average venture capitalist spends about half his time monitoring nine investments. In this light they at least seem to perform in the role appreciated by Brophy (1986), oversight, the value of which seems to be neglected by many.

The dissertation of Sapienza (1989) made a significant contribution to our understanding of the venture capitalist-entrepreneur relationship. Although focused on a secluded aspect of the venture capital process only, the study enlightened the complexity of its entirety. An insightful discussion by an entrepreneur on the complexities related to the board behaviour and roles expected of venture capitalists makes itself heard:

> "The primary importance of venture capitalists to an entrepreneur is MONEY, and they all have money, but investors do differ in objectives, motivations, and capabilities. The relationship between operating management and the business' outside investors can help or harm a business' development. Understanding objectives is the first way to help that relationship. Corporate venture capitalists may have entirely different objectives from the financial orientation of most investors... I am generally uncomfortable with corporate investors because their objectives and mine are likely to be quite different." (Kramer 1983.)

Byers (1983), a partner of the legendary venture capital firm Kleiner Perkins Caufield & Byers, underlines the importance that each investee is tailored a monitoring method based on its *need* for assistance, *willingness* to accept advise, the venture capitalist's expertise relative to its industry, and personal relationships with management. The monitoring method comprises of roles such as board member, interim officer, ad hoc volunteer, active entrepreneur, fire extinguisher, project consultant, consultant, counselor, and lecturer - the combination of which changes over the life of the investment.

In summary, value adding entails:

- deals structured, terms established, and negotiations completed (closed)
- seats in portfolio company boards assumed and work actively participated in
- relationships established for frank communication with entrepreneurs
- strategies influenced, evaluated and challenged, inside/outside board room
- introductions made, doors opened, leads given to benefit investee businesses
- preparations constantly made for finding the right avenue and timing for exit

3.4.4 Exiting: Sale of a final product?

Given the young age of the industry, particularly in Europe, it is only natural that the returns generated by venture capital companies have only recently gained more attention. In America, the study of venture capitalist performance enjoys a richer history for obvious reasons.[115]

Working on Porter's (1980) model for industry analysis, Bruno (1986) refers to entrepreneurs seeking for venture capital as the "buyers" of the industry. As evident from above, this study holds that entrepreneurs are the suppliers of the industry, whereas the parties purchasing the venture capitalists ownership stakes in their portfolio companies are the buyers or, as labelled in the language of this study, *consumers*. Figure 27 extends our framework to the stage at which the venture capitalist works to exit saleable portfolio firms. At exiting, 'divestee companies' are being offered to consumers of corporate value.

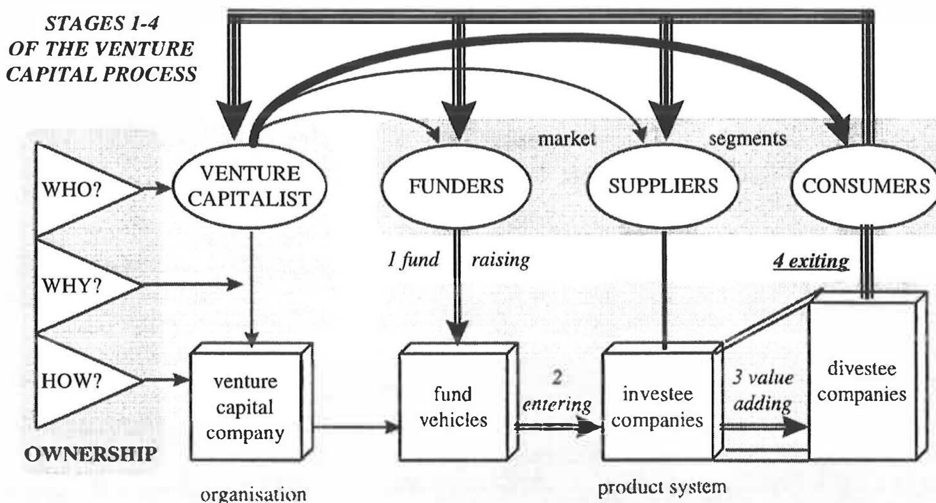

FIGURE 27 Exiting: Venture capitalist realising value-added by selling his products

The phrase 'consumer' is chosen due to the nature of the 'most-wanted' buyers of the venture capitalist: The *anonymous* participants in the IPOs of their divestee companies. Although, admittedly, venture capitalists often sell their stakes via trade-sales to industrial acquirers or even back to the entrepreneurs (suppliers).

Measuring the profitability of venture capital investing is extremely complex. The process, from fund raising to exiting an entire portfolio, is lengthy – taking often over ten years – and composed of several individual investments and exits, several rounds of capitalisation and management and other fees: A rich diversity and multitude of flows of capital. Hence, even

115 A pan-European venture capital performance survey concluded that the cumulative net IRR to 1996 was 18.6% on a pooled basis, but for early-stage funds the figure was only 5.7% (Bannock Consulting 1998).

technically (or mathematically), the profitability of a venture capital company or fund is a challenge to measure.

In addition, in general, the organisations are not easy to access for scholarly purposes. With regard to profitability, the challenge is even greater. We are dealing with a (more or less) private and secretive industry.[116] With regard to captive and governmental venture capital companies, the returns are, if possible, even harder to measure, since many of them pursue for returns not directly financial by nature. There are exceptions to the rule, of course, but (generally) "in any venture capital deal, the venture capitalists will be looking ahead to the day when they can liquidate their investment" (Hoffman and Blakey 1987). In summary, exiting entails:

- keeping various exit avenues open at all times and preparing for alternatives
- pushing divestee company 'information production' towards public stature
- packaging divestee company information for investor presentations
- selection of exit avenue (primarily an IPO or a trade sale to industrial buyer)
- approaching the right parties (brokers or acquirers) and executing the sale
- distribution of proceeds among funders as according to the agreed principles

3.5 Framework of venture capitalist strategy logic

> "There is high probability that companies in the same industry have different driving forces and, as a result, behave differently in the marketplace *because each is pursuing a different business concept*" (Robert 1988: 50; emphasis added).

In this chapter, the conceptual constructions of the preceding chapters are merged into a framework of venture capitalist strategy logic. The framework has, in fact, become incrementally built – in the course of chapter 3 – from views on the venture capital company through the *ownership, strategy,* and *venture capital process* windows.

Looking at venture capitalism as someone's business through the *ownership window,* we found the venture capital company in the middle of the picture. Venture capital firms are predominantly closely held, either owner-managed (partner-driven) or captive (single-entity-owned). Regardless of the fact that the single-owner may well be a widely-held institution, such as a large industrial corporation, a bank, or a governmental entity, its direct representatives always actively participate in the governance of the company. The only exception are publicly-held venture capital companies, whose shareholders participate via jointly appointed governors.

At first sight, when looked at through the *strategy window*, venture capital appears as a fairly simple business concept. Purchasing stakes in undervalued

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116 The typical exception is a publicly-held venture capital firm, whose investment information is readily available to investors and, hence, reflected in the share prices. Such companies do not enjoy an admirable track record either in America or in Europe as will be discussed in more detail in chapter 4.

companies as one's raw material, active investment governance to refine value, and eventual sales of stakes to realise value-added seems like another straight-forward 'production process', where profits just materialise after a longer-than-average period of time. But, there is reason to believe that the venture capital process represents only a tip of an iceberg in the real-world earning logic of players in this increasingly global and diverse field of business. So big a tip, though, that it covers the primary *interests* of the venture capitalist's *primary stakeholders*. In the light of the various stakeholder perspectives discussed in chapters 2.1.1 and 3.1.1 above, venture capitalist missions and strategies are easily misread or misinterpreted, wrongly simplified, or handled merely as reflections of the aspirations of others. What the true product-market strategies of venture capital companies are and how they are executed and governed are issues not seriously pursued before.

Through the *venture capital process window*, the characteristic business issues of a venture capital company can be locked inside the ownership-strategy framework. Hence, the framework of venture capitalist strategy logic represents a tool to examine linkages between the ownership and strategy of venture capital companies (depicted in figure 28). In the framework, the ownership related concerns and product-market strategies of the venture capital company, as well as its location in the venture capital process all vary according to the choices and preferences of the venture capitalists - leading to differences in strategy logic.

In the core of the strategy logic framework, a venture capitalist (e.g., a team of experienced executives, a large corporation, or a national government) establishes and organises a venture capital firm to manage the venture capital process in which two different products are engineered and marketed to three different segments of the market for corporate control.

First, an investment vehicle (either a new LP fund vehicle or a new issue of stock in a single LTD structure) is structured to target investments in a particular opportunity (e.g., biotechnology start-ups in America, or later stage buyouts in Europe) and participation in its capital is offered to *funders* (subscribers of LP units or shares in a single LTD structure). Potential funders vary from pension funds to wealthy individuals and from industrial corporations to national and local governments.

Second, the capital raised in the fund vehicle (topped with a value-adding element provided by the venture capital firm management) is marketed to *suppliers* (owners of prospective companies in targeted industries and situations). Traditionally, in venture capital, 'suppliers' are thought of mainly as entrepreneurs. However, suppliers include a much larger variety of different types of business owners ranging from corporations (willing to divest a division) to governments (willing to privatise a state enterprise) and from individual shareholders of privately held companies (frustrated with the illiquidity of their holdings) to financial institutions of publicly held firms (frustrated with below-potential market valuations of their holdings).

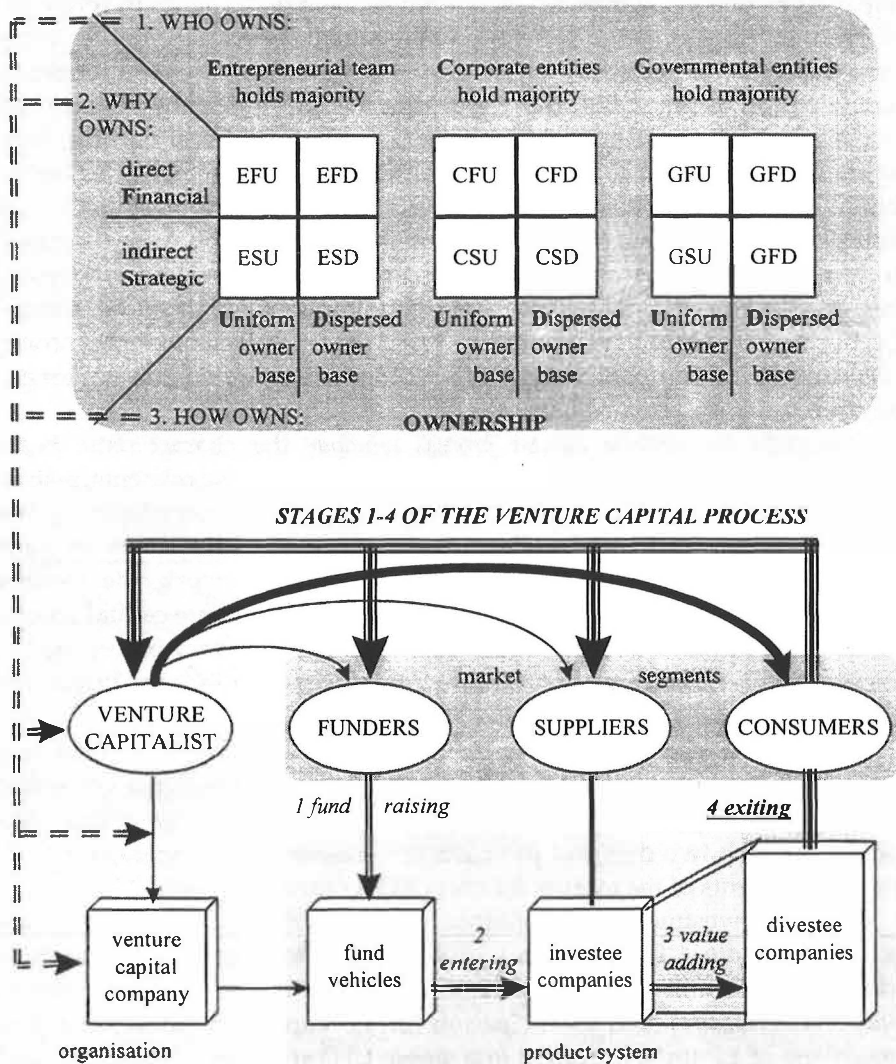

FIGURE 28 Strategy logic framework of the venture capitalist

Next (after a careful due diligence process), the value adding stage, the ultimate production stage, of the venture capital process begins. From the perspective of the venture capitalist, value adding is maximising the ratio 'total output-total input/total input' (total output less total input, the sigma divided by total input) i.e., realised return on invested capital as a function of time. The key industry term being *internal rate of return* (IRR). Value adding begins at the deal negotiation with suppliers. The structuring of individual investments produces an important foundation for the success of the whole process: Building selected portfolio companies into saleable products (the primary products of the venture capital process).

Fourth, the portfolio company holdings are marketed and sold to *consumers* (often via IPOs, or trade sales to industrial corporations) in the harvesting stage of the venture capital process. Potential consumers include financial investors (wealthy individuals and financial institutions) seeking high-performance stock of well-established and focused businesses, and strategic investors (industrial corporations) seeking expansion and growth.

The primary attention of research conducted to-date on venture capital has been placed on the venture capitalists' investment criteria and the venture capitalist - entrepreneur relationship. In other words, entering and value adding, as secluded stages of the venture capital process, have been focused the most. The secondary area, in which interest is rapidly growing, covers research on the volumes and sources of capital raised in funds on various markets, as well as returns generated by funds and avenues utilised when disposing of investments. Hence, also fund-raising and exiting related topics are being addressed, but - again - as secluded stages of the venture capital process. What remains hidden from the eyes of investigators, or has not been pursued, are issues related to the ownership of venture capital companies - who control them, why, and how - and the relative roles and importance of *funders, suppliers*, and *consumers* in their strategy logic.

A significant concern in venture capital investing is the time from a deal identification to the realisation of an investment from a particular portfolio company. A full investment cycle can last as long as ten years and the venture capitalist's inputs (combination of capital and managerial involvement) become complicated to measure. Often, the aggregate income to the venture capital firm during involvement in a particular portfolio company, becomes difficult to assess. In a word, evaluating the total performance of a venture capitalist is a *challenge* even to a company insider, let alone outsider. The strategy logic framework aims at providing a conceptual tool in support of such an analysis.

Venture capitalist strategy logic has to do with *ownership*: Personality of the owners, their activity and role in company management, nature of mission, dynamics of governance, and *strategy*: Organisation and product-market decisions; whether a company is product driven or market driven; in the *venture capital process* context: What role does fund-raising, entering, value-adding, and exiting play in the life of the venture capital company?

Venture capitalists are born small and large, individual and institutional, independent and captive. There is, however, no assurance as to how each of them will grow: A small, partner-driven venture capital company can become a large, widely-held one - and vice versa.

In conclusion so far, this study is by no means based on any existing dominant approach to venture capitalism. In fact, the founding propositions of the study - definitions of venture capital and the venture capitalist - are almost entirely inductively constructed and enjoy the support of existing literature mainly via extracted angles of propositions made by a very diverse group of scholars, discovered *ex post* during the final stages of reporting. It is possible, however, that this is exactly the kind of effort which succeeds in pulling together emerging trends and helping shape propositions for a new theory.

4 EVOLUTION OF STRATEGY LOGIC: BIRTH AND TRANSFORMATION OF A DIVERSE GLOBAL VENTURE CAPITALIST COMMUNITY

The ownership of business firms sometimes changes. So do their missions, strategies, and, consequently, governance. Not only the principals, but also the principles of governance change. What is the relationship between ownership and strategy in the venture capital context, and what happens to *strategy* when *ownership* changes, are questioned in this dissertation. The evolution of venture capitalism – from this very perspective – is addressed in this chapter.

The first venture capitalists, it could be claimed, were wealthy individuals representing inherited wealth and investing on their 'own personal account' long before the discovery of America. Today the role of *individual venture capitalists*, who after World War II began to constitute an identifiable new profession in America, is referred to as informal in the industry.

We will start our journey of evolution by examining the roots of 'business angels'. Second, we will study the emergence of *entrepreneurial venture capitalists*: How in America teams of individual venture capitalists, businessmen, bankers, and industrialists developed the industry – some sponsored by government – towards more sophisticated organisational forms and company structures by introducing the leverage factor to the venture capital business. Finally, we shall study *corporate venture capitalists* and *governmental venture capitalists* by elaborating upon how industry professionals, corporate managers, and government officials – starting in America but particularly so in Europe – moved the industry towards still greater structural diversity, less straightforward missions and increased governance complexity.

After pointing out how institutional venture capitalism became rooted in Europe, the evolution of the different venture capitalist types will be graphically illustrated in the form of a family tree; depicting venture capitalists 'climbing up the tree'.

In chapter 6, venture capitalists will be followed 'climbing down the tree' by showing how, in Finland, the trend today goes towards privatising venture capital structures, i.e., turning venture capital companies - again - into owner-managed companies. Figure 29 presents the symbols used in the illustrations of the present chapter. The definitions and symbols and their order of listing provide some insight into what is ahead.

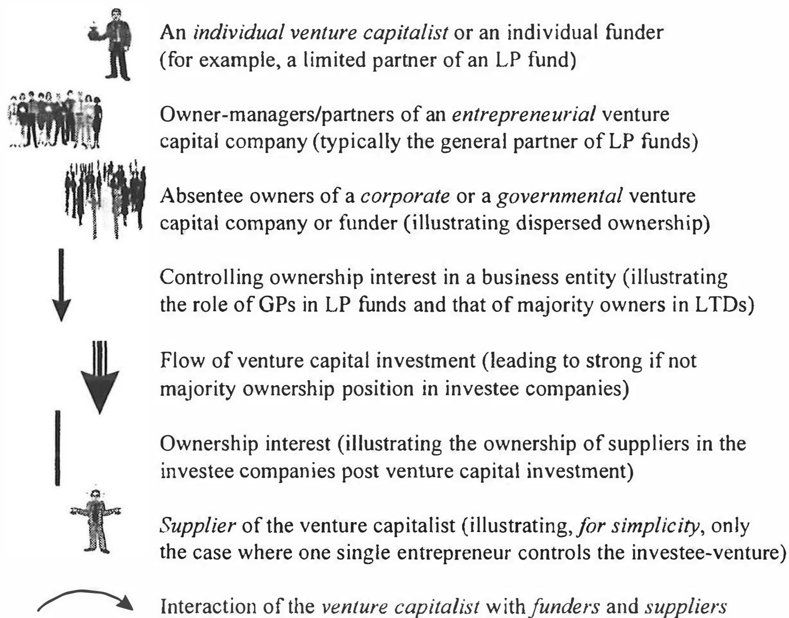

FIGURE 29 The symbols used to describe the evolution of venture capitalist types

4.1 *Individual* venture capitalists: Owners with a face

The story of venture capitalism, leading to today's diversity of players and playgrounds, started in America over 50 years ago or - better - in Europe (resulting in the *discovery* of America) over 500 years ago.[117] Tyebjee and Vickery (1988) note to the point, however, that "though the roots of capitalism are in Europe, it is in [America] that it has flourished." And, as concluded by Daems (1978: 25), "it is crucial for an understanding of the financial intermediation in Europe to speculate, without going into great detail, about the historical reasons for these remarkable differences between [America and Europe]."

[117] In the words of Pratt (1983), "venture capital was instrumental in the discovery of America." Hazen (1988) sees the beginnings at even earlier times: "venture, or risk, capital has been profitably invested at least since the Phoenicians mounted trading missions around the Mediterranean."

4.1.1 *Private* venture capitalists

4.1.1.1 The story of America

> "While venture capital was instrumental in the building of America - from Queen Isabella backing Columbus to Pierre DuPont's investment in General Motors - its institutionalisation did not begin until after World War II. Previously, most venture investments were made by wealthy individuals, syndicates organised by investment bankers, or by a few family organisations employing professional managers. Several of these pioneering venture investment firms, such as Bessemer Securities, Venrock Associates (formerly Rockefeller Family & Associates) and J.H. Whitney & Co., continue to be active today." (Morris 1992.)

It is almost classic to begin the story of venture capital by explaining how it was not discovered *in* America but, essentially, *with* the new continent. In the 1490s in Europe, a 'royal venture capitalist' decided to back an adventurous entrepreneur, the consequences of which decision are known to all. Although venture capital began to emerge as an industry only about 50 years ago in America, many of the modern dynamics of the business are to be found in the 'Queen Isabella - Christopher Columbus' story; the one quite popularly referred to as the first tale of successful venture capital investing.[118]

To begin with, Christopher Columbus, determined there was another way to India, *did not find his venture capitalist at home* in Italy - or in Portugal - but in the rival Spain, and he had to go through tough negotiations on foreseen 'property rights' and other 'financial terms' of the deal. In modern-day venture capital, too, entrepreneurs have to go from door to door, as venture capitalists have different investment philosophies - and some are hungrier for different covenants than others. In the Europe of today, such doors in *different countries* constitute increasingly natural alternatives for entrepreneurs.

Furthermore, Columbus did not find a way to India, but to something bigger. Queen Isabella's investment was rewarded by the discovery of an entirely new continent.[119] Originally, she had commended an investment in the venture based on the 'unproved innovation' that, the earth being round, sailing off West was a faster route to the Far East. Harvested optimally by the Spanish crown, or not, the discovery of America was unarguably 'a phenomenal return on investment'. This is the first time a venture capital investment is known to have triggered an unforeseen - and completely unplanned-for - economic revolution. A classic case, it also demonstrates the value of a venture capitalists' (not just the entrepreneurs') daring action.

The classic case also tells us an important story of the nature of the early venture capitalists. Due to wealth distribution and the absence of corporate structures, the individual owners of capital - often members of royal families or heirs of other similar concentrations of wealth - themselves acted as venture capitalists.

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118 According to Henderson (1988), it can be "accurately described" as such.

119 Disregarding the visits by Vikings on the American soil long before Columbus (in venture capital reality, too, those who commercialise a new innovation are better remembered that the ones who invent it).

Interestingly, the venture capitalist of this founding case of the industry is a *woman*.[120] As this part of the story is not at all descriptive of the field during its *first* half millennium - or half century, depending upon where we look - let it serve as a projection for the *second* half. The first half century of professional venture capital investing has been dominated by men, as becomes evident in our discussion on the *founding fathers* of the industry.

Clearly, on the new continent, enterprising individuals - both *venture capitalists and entrepreneurs* - have played a big role in turning a *bundle of European colonies* into the world's leading nation. The building of America has been largely based on the initiative of individual start-up entrepreneurs and self-made capitalists, rather than nobility or corporatism of any kind - the likes of which have been seen in parts of Europe. From the earliest days, enterprising individuals have been appraised as national heroes in America, and becoming a self-made-man the much-cited *American dream*. In such a value environment, the venture capital process was silently utilised and refined over several decades before it was put to work professionally after World War II, and before it was imported *back* to Europe some 20 years thereafter.[121]

"In one way or another," say Klaasen and Allen (1980: 2)[122], "the monied with some willingness to gamble have helped spawn virtually every modern-day industry, from steel and aircraft to electronics, computers, and communications." During the early days of New Orleans (as a port) both *European* and *New Orleanian* merchants were financed in the 1700s "by venture capital from wealthy European families such as Rasteaus of LaRochelle." Chandler (1962: 386) attributes the development of the investment banking sector, in America, to "the needs of the railroad for vast sums of capital" of the post-Civil War era. This led to the growth of the modern money market in America and "made it relatively easy later for industrialists to tap a wide pool of European and American capital."[123]

As a consequence, regardless of Queen Isabella's pioneering contribution, venture capital is at heart an American phenomenon. Classically, the philosophy appraises the entrepreneur, the individual that goes against all odds and works hard to challenge the prevailing business concepts, prevents and breaks monopolies, and hence contribute to the functioning of the market economy and, essentially, the well-being of fellow citizens. At best, venture capitalists can be seen as doctors working to keep capitalism healthy. The core idea behind the venture capital process is the notion of creating economic

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[120] Indeed, Queen Isabella of Spain could be referred to as the *mother* of all venture capitalists.

[121] Even as close as Canada, a much different enterprising culture emerged. Twenty years ago it was publicly addressed how Canadians were more reluctant in their praise of individual success and more comfortable with less conspicuous individuality - the professions, government, and bureaucracy, while Americans appeared to "worship individual success and had indeed created an entrepreneurial society of free enterprisers" (Fells, 1989).

[122] Original source Smith (1978)

[123] According to Hambrecht (1984) particularly "several of the Scottish trusts" were active in the financing of the new industries in America in the 19th century; a role in which they are again active today.

value-added by backing efforts to perform certain market functions better and more efficiently than has been done before. Venture capitalists and prevailing industrialists are, by definition, *competing forces* on the market. Hence, it is not unimportant who - exactly - operate as venture capitalists in an economy.

4.1.1.2 From founding fathers to informal players

Before the invention of incorporated forms of business activity, i.e., when individuals were mainly enterprising directly on their own personal account, even venture capital investment activity (which must have been marginal at best) was strongly personalised. Wealth was mainly inherited and concentrated in the hands of relatively few individuals or families. Particularly this was the case with such 'excess wealth' that was both *available* and *seeking* for outside-the-family businesses to back. Again, it is appropriate to make a reference to Christopher Columbus to whom a royal venture capitalist was about the only alternative.

By our times, individual venture capitalists have lost their *dominant* position even in America. While in America their investments still constitute approximately one half of all venture capital investments made, their role is estimated to be less significant in Europe, owing to differences in national fiscal and saving traditions. Business angels are, by definition, secretive and silent operators difficult to find, follow, and examine, and hence to even accredit for the valuable work they do.

> "To an entrepreneur, an angel is a person willing to take a chance and invest in a small, start-up business. According to recent research, angels pump about $20 billion a year into small companies (in America) which is about what professional (venture) capitalists invested last year. Angels tend to look for entrepreneurs who can benefit from their experience in specific areas of the business world such as marketing or finance." The Michiana Investment Network (1997), a partnership program with the SBA (http://www.michianatoday.com/sbdc/min-news/1997-4/angels.html). [124]

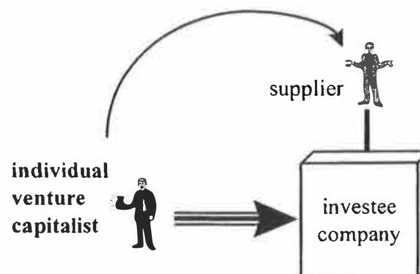

FIGURE 30 Portrait of an *individual* venture capitalist making *direct* investments

Figure 30 serves to demonstrate the contractual simplicity of an investment by an individual venture capitalist in an investee venture. The *ownership of the*

124 Further reading on the important role of business angels in the modern economy, with some evidence from the Finnish market, see Lumme, Mason, and Suomi (1996).

venture capital company is no issue, since there is no company structure and, more importantly, the owner of the capital is personally in full control of the venture capital process. Respectively, the *mission of the venture capitalist* and the *governance of its fulfilment* constitute no potential conflicts either. On the other hand, while by definition no governance of *the venture capital operation* is necessary from the perspective of the venture capitalist, there is always a mission. However, in the case of an individual venture capitalist the truly-pursued mission is extremely hard to discover, due to the fact that wealthy individuals may engage in venture capital to serve a *range* of interests. Direct financial return is classically mentioned, along with the desire to be socially responsible by putting some of the hard-earned fortune back into the system that provided it in the first place. Which of the two dominates, and whether there are yet other interests being served, are difficult to verify in an interview or from written documents. One should live close to a business angel, or be one, to gain an ideal access to this phenomenon; and, even then, it would be a single case study with little relevance in terms of universal explanation of a business angel's mission.

Historically, when reviewing the evolution of financial institutions in America, venture capital companies are a recent and exponentially developing phenomenon. While the first life insurance company was established in 1759, the first state-chartered commercial bank in 1781, the first national bank in 1793, and the first savings and loans association in 1831, the first venture capital company was established in 1946 (Dominguez 1974: 1-2).

4.1.1.3 Incorporation: Paving the way for the leverage factor

> Venture capitalist B: "Jock Whitney liked to tell the story that, during World War II, he was shot down on a mission over Germany and was captured by the Germans. As he was interrogated with a couple of other American soldiers, who were POWs with him, he was asked what his occupation was; and he said: 'Well, I guess I am a capitalist.' Jock said he did not know whether the Americans or the Germans liked the least of that. He was shocked by the reactions of the Americans to somebody labelling himself a capitalist. And he thought this was a bad idea, that his family had made a good deal of money, and that he ought to do something and put some of that money back into the American system. And so after World War II he formed J. H. Whitney & Co." (1990 Venture Forum, San Francisco).

"Fine old firm"

The founding of J. H. Whitney & Co., in February 1946, under an initial capitalisation of $10 million, is recognised as the birth of the world's first venture capital company (Dominguez 1974: 2, Reiner 1989: 143). As legendary an event as it proved to be, the founding instantly led to one of the "great old jokes of the industry" as colourfully depicted by an industry grey-beard below:

> Venture capitalist B: "[Jock Whitney had] invited some of his friends to help him form the company. They met at lunch and agreed they would form J. H. Whitney & Co. This was done at some gentlemen's club in New York and after the lunch they went downstairs.

> One of [Jock Whitney's] partners, who was a man at time of probably 45-50 and who was chairman of some other company, was asked by an 80-year-old gentleman: 'So, what are you doing these days?' He said: 'Well, I guess I am a partner of J. H. Whitney & Co. now' (after the deal they made about 15 minutes before). And the old gentleman said: 'Oh yeah, J. H. Whitney, J. H. Whitney - fine old firm, fine old firm'." (1990 Venture Forum, San Francisco).

John Hay Whitney, who was a former U.S. ambassador to Great Britain, saw himself as a "philanthropic underwriter of the industrial and technological growth of America." His mission as a venture capitalist was to provide capital and managerial assistance to new enterprises that might have difficulty attracting capital from more traditional sources. His thesis was that unless private sources became less risk-averse, "there was a strong possibility that the government would intervene and socialise the industry." (Dominguez 1974: 78.)[125] Having inherited a vast fortune, at a young age, John Whitney made his first investment in 1929 by investing $500,000 in a Texan sulphur firm. In 1957 the stock was worth $10 million. In the 1930s and 1940s he participated in several different types of deals as a private venture capitalist - the *Newsweek* magazine and the movie *Gone With the Wind* among them (Klaasen and Allen 1980: 5).

Strategy logic

J.H. Whitney & Co. was formed as a partnership; originally with four partners, later expanded to eight. The organisation included several associates facing prospects of promotion to junior partnership. In terms of professional backgrounds, corporate law, engineering, investment banking, and commerce were represented within the firm. According to Klaasen and Allen (1980: 5), the firm was guided by the personal philosophy of its founder, who understood that involvement in new businesses was a "long, difficult, and risky process, best handled in an organised manner." Whitney felt the investors like himself were obligated to "encourage inventions, to promote new ideas, and to finance projects that might be considered social infrastructure investments."

Whitney associated himself with the responsibility of a trustee to maintain and preserve the institution of private enterprise. While his purpose was to build creative men and their companies, capital gains were seen as rewards rather than goals in themselves. Whitney would focus on the viability of the product idea, rather than solely on the creative drive of the entrepreneur. (Dominguez 1974: 78.) Whitney himself took the lead in evaluating many of the firm's investment opportunities until 1957 (Wilson 1986: 18).

J.H. Whitney & Co. would often settle with minority stakes in its investee businesses (Klaasen and Allen 1980: 7), perhaps because it felt secured by its primary focus on the product. In the experience of Shames (1974: 103)

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125 Interestingly enough, for exactly this reason the government later ended up taking leadership in venture capital finance in Europe. No other industry but venture capital itself 'became socialised' in the process, however, and only 'temporarily' there, too (see chapter 6 on case Finland).

"investors often judge the product or technology instead of the people because it lends itself to objective analysis and is therefore easier to do."

Qualities sought for in an entrepreneur, spelled out by Benno Schmidt, founding partner of J.H.Whitney and Co., comprised of "the attributes that separate any outstanding man from the average man: Keen intellect, stamina, the ability to attract and move people, sort out ideas and avoid wasting time on ancillary or auxiliary matters" (Klaasen and Allen 1980: 5).

J.H. Whitney & Co.'s most successful investments included Minute Maid citrus products (Dominguez 1974: 2), a spin-off of an earlier investment in Vacuum Foods, started with an additional investment of $15,000 (Wilson 1986: 18). Aother successful investment was Spencer Chemical Corporation: An investment of $1.25 million in 1946 grew to a total valuation for the investee firm at $150 million by 1963, when acquired by Gulf Oil. By 1948, Whitney estimated that the firm was "well on its way to doubling its capital." By 1960, the firm "reportedly quadrupled" its original capital. (Klaasen and Allen 1980: 6.)

Whereas the incorporation of venture capital operations can be seen as the field's *crossroads* to institutionalisation, the share register of the venture capital company is the *runway* thereto. Figure 31 illustrates the setting where a single individual controls the venture capital company - with no outside funders involved - much as was the case with J.H.Whitney & Co.

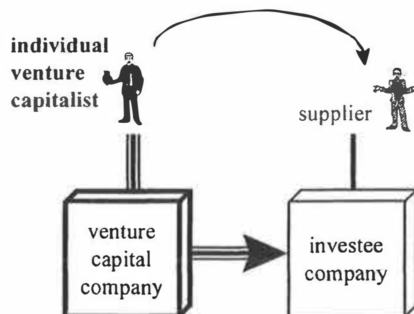

FIGURE 31 Portrait of an *individual* venture capitalist making investments *via* a single LTD structure

As long as there is only one shareholder in a venture capital company, and as long as the person is the owner-manager, we are dealing with an individual venture capitalist. But as soon as he opens the ownership of the company and invites either new partners and/or passive investors as his fellow-shareholders, the venture capitalist turns entrepreneurial. Once the majority control shifts from the management to company-outsiders, the venture capital company has either a corporate venture capitalist or a governmental venture capitalist, depending on whether the source of capital is the private or the public sector.

Long after separation of ownership from control reported by Berle and Means (1932), venture capital remained a private and strongly individualistic field of activity: A playground of a few wealthy individuals and families in

America. However, some of the first incorporated venture capital companies that can be said to have launched the institutionalisation of the field were established by the founding fathers themselves. Interestingly, *institutionalisation*, which the individual venture capitalists started in venture capital, could be identified as the force that had driven them from industrialism to venture capitalism, in the first place.

> "Jock Whitney, Laurance Rockefeller, Richard K. Mellon, and their relatives who helped them form venture capital organisations were members of the third generation to possess extraordinary fortunes created in the era of financial capitalism. By the third generation, the founding families of almost all large US business enterprises were no longer involved in the management. The separation of ownership of the great industrialists' descendants from the control of their inherited ownership seemed widespread in the post-war years" (Reiner 1989: 137).

The founding thesis of the present study that venture capital should be examined as an *ownership* rather than finance-related phenomenon culminates in the above quote; that venture capitalists are *owners back in business* rather than merely financiers of uncertainty.[126]

4.1.2 *Entrepreneurial* venture capitalists

4.1.2.1 SBIC program: An early private-public partnership

The government has had an important role in the development of the venture capital industry also in America. The government's early contribution culminated in the SBIC program set forth by the US Congress, in 1958, as the Small Business Investment Act. This was one of the first government programmes, in the words of Klaasen and Allen (1980: 3), "recognising the need for the private sector to do a job which the government could not do and which was not fully covered by existing venture capital sources."

> Venture capitalist F: "[Small Business Investment Act] basically provided for borrowing government funds at very low rates by registered companies which would then in turn invest in small companies as defined by the government. It looked like a license to steal. Accordingly, by the time, 1963, there were over one thousand SBICs." (1990 Venture Forum, San Francisco).

The SBIC program permanently altered the nature of venture capital business. Previously, venture capitalism was reserved - as a business - for wealthy individuals, the likes of J.H. Whitney, who could build on their personal funds, and for corporate and institutional players, such as the founders of American Research and Development Corporation (ARD, est. 1946; the case of which will be reviewed in chapter 4.2.1.1). In fact, there had been a significant *barrier* of entry to the venture capital industry. All of a sudden, the key barrier of entry

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[126] Based on this same insight, the concept of risk is not elaborated upon in the study, as explained in chapter 1.2.

to this historically *capital intensive* industry was removed by a government decision.

An entirely new breed of venture capital players emerged. In the words of another pioneering SBIC venture capitalist (below), the government was primarily viewed as a *funder,* in the exact sense of the word, by the emerging group of *venture capital entrepreneurs.*

> "The only reason to have an SBIC is to leverage your own capital." Franklin P. Johnson, who started in venture capital in 1961 by forming an SBIC (Reiner 1989: 330).

According to Klaasen and Allen (1980: 4) the minimum capitalisation of an SBIC is $500,000 "plus enough cash to cover operational expenses." The SBA undertakes to approve articles of incorporation, by-laws, partnership agreements, proposed policies, and capitalisation, as well as background information of all officers, directors, and shareholders with more than 10% of equity, before an granting a license. "SBA leverage is available, if private sources are exhausted, in amounts three times the SBIC's paid-in capital and paid-in surplus. Thus, an SBIC with initial capital of $500,000 can borrow up to 1,500,000 and begin operations with a total capital of $2 million."

The US Small Business Administration was, for years since 1958 it is fair to say, the world's leading funder of venture capital business. Figure 32 illustrates how the venture capitalist, the funders, and the suppliers are brought together under a single LTD structure SBIC.

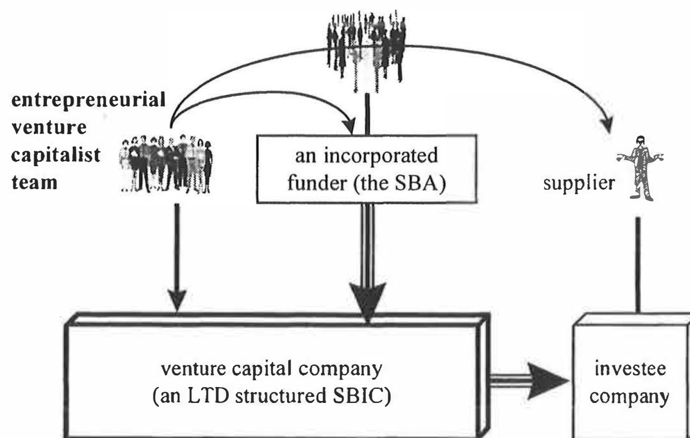

FIGURE 32 Portrait of an *entrepreneurial* venture capitalist *team* making investments *via* a single LTD structure (e.g., an SBIC)

Strategy logic

Dominguez (1974: 3-8) refers to SBICs as *quasi-public venture capital companies* whose mission was to "stimulate and supplement the flow of private equity capital and long-term funds which small business concerns need for the sound

financing of their business operations and for the growth, expansion, and modernisation." However, as pointed out by Shames (1974: 116), SBICs are privately organised and managed: "Investment decisions are entirely at their own discretion."

Dominguez (1974: 3) traces the initiative behind SBICs to England, where in 1931 the British Committee on Finance and Industry conducted the first major study on the financing problems of the small businessman, which later became referred to as the "Macmillan gap." During 1935-1940, the American government conducted similar studies leading, in 1953, into the establishment of the SBA. In 1957, the Federal Reserve Board concluded that SBA's role as a long-term lender was inadequate to close the 'Macmillan gap'. Henderson (1988: 255) underlines the role of the Federal Reserve System in getting the law passed in 1958.

The SBIC Act was signed into law by president Eisenhower in August 1958, and the first two SBICs were officially licensed in March 1959. By the year end, a total of 68 SBICs had been licensed. "One reason for the industry's slow formation was that until February 1959, the SBA refused to consider applications for SBIC licenses from groups planning to rely solely on government financing." Consequently, the National Association of Small Business Investment Companies (NASBIC) was formed to advance the issues in Washington. During 1960-1962, when the Kennedy administration intensively promoted the SBIC program, nearly 500 new venture capital companies were established, including 45 SBICs that raised over $300 million in public offerings. During this time, even commercial banks began forming wholly-owned SBIC-subsidiaries. (Dominguez (1974: 4.) Shames (1974: 115) attributes the peak of the early 1960s to the increased power of the federal government in general, and the recognition of "the leverage of venture capital for new ventures, in creating jobs."

SBICs are classified either as captive or non-captive, the former being a company whose investment philosophy is determined by the objectives of a parent organisation and the latter being an individually owned and independently operated firm. Typically, SBICs are small even for venture capital firms. In 1985, 40% had less than $1 million and only 12% more than $5 million in private capital under control. (Henderson 1988: 257.)

Many started up in venture capital by forming an SBIC with a genuine interest to make money by buying into, adding value to, and selling interests in prospective small businesses. But not all, as becomes evident from the quote below (which should be remembered when addressing the Finnish experiments in chapter 6.1.2.2).

> "At the same time, venture capital funding came to the attention of real estate brokers and investors who saw the SBIC program as an ideal way to gain leverage in their own equity base. A number of smaller SBICs were formed for the express purpose of making loans and investments in real estate and related areas. They did not provide significant equity financing to small busiensses other than real estate developers." (Dominguez 1974: 4-5.)

The SBIC program attracted players of a wide variety, some with good and others with *less good* intentions.[127] Some were successful, some were not. SBA had driven its objective to make the SBIC program move as quickly as possible by employing licensing standards that "merely required the absence of a criminal record and the completion of organisation papers by the principal shareholders of the licensee." After realising that "undesirable elements had crept into the SBIC programme, SBA started to tighten its interpretation of the rules before year end 1961, including monitoring and suspension of license, turning SBA into "the industry's policeman." (Dominguez 1974: 5). The ease of entry to the venture capital industry by often inexperienced, overly optimistic management teams resulted in a difficult period, and a *period of consolidation*, from 1962-1970. During this era, several SBICs went out of business and, by the end of the decade, the number had fallen to fewer than 300 (Henderson 1988: 256.)[128]

> "[Over one thousand SBICs in 1963] was the peak and that number has fallen dramatically since then, probably to less than 20% of that number. I think the reasons for that are, in part, that the private sector began to recognise this category, that we now call venture capital, and the government funds were practically no longer needed. However, I think that might have been exacerbated by the fact that the Government organisations became progressively more difficult to deal with, the forms you had to fill out became progressively more arcane, etc." Brent T. Rider, General Partner, El Dorado Ventures (1990 Venture Forum panel discussion).

While the original 1958 Act had enabled an SBIC to obtain a maximum of $4.7 million in government funds when it had $7.3 million of private funds, a 1967 Amendment permitted the SBA to advance up to $10 million to an SBIC having only $3.67 million of private capital (Dominguez 1974: 6). However, shortly after the Amendment was passed, the government faced budget cuts, and SBICs faced with a funding shortage.

Pratt (1983) attributes unreasonable expectations, inadequate private capitalisation, a short-term investment orientation, excessive government regulation, poor economic and market conditions, a lack of experience, and widespread misunderstanding of venture capital investment disciplines as the factors that "almost destroyed the infant industry."

Forty years after a state *government* took active measures to build venture *capitalism* in America, Europe as an emerging single market benefits from the rich variety of governmental incentive scheme experiments of the past both in America and in the different local markets of Europe. Europe also benefits from the structural innovations and evolution of industry wisdom over time. A key

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127 "A few out-and-out crooks crept in through the SBA's superficial licensing controls, and there were many practitioners of not-quite-illegal 'daisy chain' investing, in which SBICs loaned each other enough money to recover their private contributions to the business before they started risking the SBA money." (Wilson 1986: 21-22.)

128 In 1985, their total number was up again, at 518, according to Henderson (1988: 257). Of the number, only 372 were traditional SBICs, however. The rest (146) were Minority Enterprise Small Business Investment Companies or MESBICs who could only invest in businesses whose majority ownership is "disadvantaged" (such as representing a minority race or ethnic group).

advantage for Europe of today over the America of forty years ago relates to the discovery and evolution of the limited-life limited partnership (LP) fund vehicle. [129]

4.1.2.2 Discovery of the LP structure

Recognising the mistakes of the SBICs, particularly their short-term investment orientation, a number of privately owned venture capital firms were formed *free from government regulation* to take advantage of an untapped segment of the capital market and, by the late 1960s, they began to experience quite some success (Henderson 1988: 256). Shames (174: 104) underlines that - regardless of a *bull market* in the public stock arena - venture capital was a *bear market* during 1962-1966. The second peak of venture capital was the period between 1966-1968, but there was a considerable difference in the investment pattern: Having been often burnt by the entrepreneur-inventor as a single individual, venture capitalists now preferred to bet on teams. This applies to funders as well: Even funders were increasingly betting on teams of individual venture capitalists.[130]

Venture capital was entering an important development stage: It was turning from a culture where *an individual venture capitalist financed an individual entrepreneur* towards a culture where *a venture capitalist team financed an entrepreneur team.* Consequently, interest in assessing the 'goodness' of a team, instead of an individual began to prevail. Several practical tools for the assessment of such soon became available.[131]

One of the first private venture capital companies that managed the funds of more than one family was Greylock & Co. The firm was founded in 1965 by William Elfers, a former associate of General Doriot at ARD (in fact two of Greylock's founding figures were 'ARD graduates', an issue returned to in chapter 4.2.1.1). "Greylock was set up from the beginning as a partnership, promising big rewards for its principles that General Doriot [of ARD] could not match, and the format was quickly copied by others" (Wilson 1985: 99). [132] The Greylock model can be said to have created a standard for the modern venture

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[129] In 1995, Finnish Industry Investment Ltd was established as the government's *fund of funds* to accelerate fund-raising efforts of entrepreneurial venture capital companies and, by the end of the decade, the mandate of the European Investment Fund was changed to enable similar participation on the European level. These operators have followed, *early on*, far more rigorous monitoring principles as funders than SBA did forty years earlier.

[130] Reich (1992) underscores the value of team ownership to entrepreneurial success. Interestingly enough, the partnerships of venture capitalists have gone unnoticed as prime examples of the relevance of this point.

[131] For example, according to Darling (1985), effective organisations are made up of a good balance of individuals representing different "social styles." Regarding the challenge of constructing such teams particularly of *entrepreneurs*, see Sexton and Bowman (1985) on the psychological and sociological characteristics of the entrepreneur, and the implications with regard to "organisational behaviour and management style."

[132] According to Waite (1983), a founding partner of Greylock and himself an 'ARD graduate', Greylock & Co. "liked to back people who have the reputation of being the best in their particular industry." The company's key principals had been involved in venture capital since the early 1950s.

capital industry (Bartlett 1988: 6). A general portrait is provided in figure 33 (the industry standard discussed already in chapter 3.3.2).

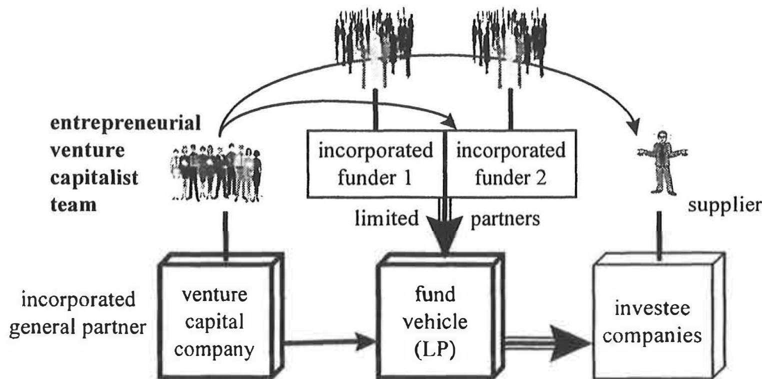

FIGURE 33 Portrait of an *entrepreneurial* venture capitalist *team* making investments *via* an LTD structured venture capital company *utilising* the LP fund structure

Strategy logic

Entrepreneurial venture capitalists are often synergistic teams of business professionals, owner-managers of venture capital companies. The power is in the partnership. There is *less* internal struggle over formal power or organisational positions than in companies run by hired managers; and individuals are expectedly more committed. In the words of Michael J. Levinthal, a general partner of the Mayfield Fund: "It's a partnership twenty-four hours a day" (Wilson 1985: 57).

> "Venture capitalists are always talking. There are few exceptions, but most of the venturers I know are forever on the phone, in meetings, en route to meetings or, with the help of a mobile telephone, all three at once. [133] They read voluminously, but information on the people and concepts involved in high-technology venture deals is both sensitive and perishable. The way to get it, usually, is in person. And the way to use it, at least in the small private partnerships that have come to dominate the field, is in free-wheeling debate among partners." (Wilson 1986: 167.)

According to Sanford Robertson, the investment banker who introduced Perkins to Kleiner and helped them raise money, "they acted as entrepreneurs. That is what really sets them apart." Admitted by a competitor, the level of expertise and energy is unusually high at Kleiner Perkins: "The feedback we get from entrepreneurs is that they can go to Kleiner Perkins and get more insight into a technology than we have here. [But there is the flip side:] These people

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[133] "Before I met Peter, I didn't know being a venture capitalist meant making so many phone calls, sometimes 50 to 100 on one deal. But my failures have often been tied to not making enough calls." Jean Delage, a San Francisco based venture capitalist trained by Peter Brooke, the creator of the world's largest global venture capital group, Advent International. Says Anna Brooke (wife of Peter Brooke): "If we had a car phone we'd be the laughing stock of the community." (Fortune 1987: February 2).

have very strong personalities. Some entrepreneurs like that and some don't." (Wilson 1986: 72-73).

> "The first venture capital team to take up residence at 3000 Sand Hill Road in 1972 seemed like an oddly matched pair. Eugene Kleiner, sober and practical, balanced his old-world formality with a kindly nature and a genuine love for the dust and grease of a machine shop. Thomas J. Perkins, driving and restless, was a charismatic corporate gamesman with a gambler's nerve. They were both entrepreneurs, however, and they had the same activist approach to venturing." (Wilson 1986: 69.)[134]

Typically, a venture capital company is established by an entrepreneur team to pursue a shared mission based on a shared vision of an investment opportunity, and following a unanimously approved investment strategy. The investment opportunity is often based on the combined expertise and experience of the founding partners and often they have backgrounds as successful executives or entrepreneurs in the targeted business, market, or stage of industry themselves.

They create a fund vehicle and a fund raising plan which they believe will get them into business. Teams with little combined investment track record and limited ability to invest own money have increasingly hard time getting onto the market. In the words of Porter (1985), barriers of entry are on the rise in venture capital. As the size of the average fund raised on the market is constantly growing (because many established players are on their third-to-fifth fund already), teams raising their first fund will have trouble justifying the large fund size the market is expecting at minimum. On the other hand, beginners pursuing modest fund sizes will have trouble justifying their higher-than-market management fee. As the sizes of the funds raised have been growing, funders have consequently pressured to decrease the management fee percentages.

In the case of a limited-life LP fund vehicle, the owner-managers of the venture capital company typically invest combined one percent of a new LP fund vehicle's total capitalisation. They receive compensation for their efforts as general partners on a *cost plus success fee* basis. An LP fund typically pays the venture capitalist an annual management fee of ca. 2.5% on the committed capital of the fund plus ca. 20% carried interest on the net profits of the fund once the initial capital has been returned to the fund investors along with a preferential return, referred to as the 'hurdle rate'. Thus, as a 'carrot', the entrepreneurial team stands to gain significantly by making the best of their role as *empowered capitalists*. On the other hand, there is a 'stick' built-in. A fund usually has a limited life, often ten years, during which the funds need to be circulated throughout the entire venture capital process, entering through value-adding *through* exiting. If the performance of the fund is not good the team will have trouble raising a follow-on fund. Reversed, success breeds success.

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134 For an overview of venture capital and the growth of the Silicon Valley, see Hambrecht (1984).

Shames (1974: 124-125) summarised 1958-1962 and 1966-1968 to have been the two first major waves of venture capital activity, and projected a third wave to come. He envisioned that "it will be characterised by different standards and patterns of organisation," and quoted a partner of a large venture capital firm as follows:

> "The next time I do a private deal, I will keep control of the company. The investors in the deal, including my own firm, will in effect be betting on me, and I will be betting on individual companies with whom I will stay very close, demand tight budgetary controls, and hire and fire when necessary."

In his observer's view, Pratt (1983) echoes the sentiments of the above quote by concluding that the "myriad of difficulties" experienced by venture capitalists during the early to mid-1970s was traumatic but educational to the young industry. Looking back how "unventuresome" venture capitalists had become, as a consequence, Gumpert (1979) found reason to propose that "perhaps the venture capital industry has become misnamed and its participants should really be known as 'development capitalists'." Similar concern is presented roughly one decade later by Bygrave and Timmons (1992).

4.1.2.3 Venture capital spiral of institutionalisation

> "The startling success of their first fund allowed Kleiner and Perkins to raise a second of $15 million, a third of $55 million, and a fourth and fifth of $150 million each - a megafund that at the time was the largest pool of venture capital ever assembled by a private firm" (Wilson 1986: 69).

Success breeds success. Money comes to money. These sayings are all very descriptive to the venture capital business. As was referred to above, success with one LP fund *naturally* leads to raising another such fund but only bigger. This leads to an inevitable increase in the minimum investment amount that can be economically considered by the venture capital firm. Also, there is a pressure to expand the organisation as well; to hire more new associates. The following table illustrates the growth of the venture capital pool in America, from 1969 to 1984.

TABLE 7 Growth of the total venture capital pool in America 1969-1984

Figures in $Millions	*1969*	*1977*	*1982*	*1983*	*1984*
Independent private	n.a.	887 M	n.a.	8,157 M	11,800 M
SBICs	n.a.	612 M	n.a.	1,365 M	1,638 M
Captive corporate	n.a.	1,022 M	n.a.	2,554 M	2,870 M
Total pool at year end	*2,500 M*	*2,521 M*	*7,500 M*	*12,076 M*	*16,308 M*

(source: Venture Economics 1984, 1985)

Following the 1973 recession, during which time venture capital companies and SBICs had been "unpopular investments" (Klaasen and Allen 1980: 11), an important development took place in America that opened up a new permanent source of capital to venture capital organisations. The government's

1978 change in interpretation of regulations in the Employee Retirement Income Security Act (ERISA) allowed a pension fund to place a percentage of its assets in "supposedly riskier investments that offered higher rates of return." In the early 1980s pension funds more than quintupled their annual investments into venture capital funds. (Wilson 1985: 27.)

"Where there is more uncertainty, there is more co-investing," Bygrave and Timmons (1984: 452) already concluded. Syndication is a way to tackle some of the problems faced by growing venture capital organisations. It offers a possibility to share both work load and investment risk. Syndication makes it possible for established venture capital companies to obtain information in order to decide whether to invest in risky firms. Lerner's (1994) findings also suggest that increased reputation increases risk aversion: "For instance, more established venture organisations may be willing to accept lower returns as long as the variance is lower." On the long run, a historical low variance of performance on previous funds is a better asset in fund raising than top performance of only one previous fund.

The lure of growth of number and size of funds under management also bears elements of concern when it comes to maintaining efficiency as an overseer of the market economy. Venture capital is not free of the pitfalls of the businesses they build and monitor. Jensen (1986) points out that managers have incentives to grow their firms beyond the optimal size: "Growth increases managers' power by increasing the resources under their control. It is also associated with increases in managers' compensation, because changes in compensation are positively related to the growth in sales." With regard to venture capitalists utilising the LP fund structure, every new fund increases the company's annual 'sales' by the amount of the annual management fee; which is affixed for the life of the fund. In other words, working with a product the sale of which accumulates secured revenues for several years, only the most irrational man would fail to maximise growth.

Much of the wisdom applicable on an investee company evaluation could apply to the evaluation of venture capitalists (by funders, entrepreneurs, and governments alike). In the words of Arthur Rock, "if you're going to succeed, you must have a burning desire to develop your idea; you must believe so firmly in the idea that everything else pales in comparison. I usually can tell the difference between people who have that fire in their stomachs and those who see their ideas primarily as a way to get rich. Far too many people are interested in building a financial empire instead of a great company. I want to build companies. That's how I get my kicks." (Rock 1987.)

There are some in venture capital, too, who trust in the power of organisation. Peter Brooke, the founding president of TA Associates, was said to have "broken every conventional wisdom in almost every way in his remarkable effort to institutionalise and internationalise the process of risk investment." Under Brooke's guidance the firm created a structure and style that was more corporate than collegial, more reliant on strategy and analysis than on intuition. In the words of a former partner: "Peter is one of the few

visionaries in the venture capital business. He recognised earlier than most that it was not going to be a club forever." (Wilson 1986: 101).

In 1968 Peter Brooke established a venture capital subsidiary for Tucker Anthony called TA Associates. Between 1975-1978, he and his colleagues bought out Tucker Anthony's interest in TA Associates (Fortune 1987: February 2). In 1968, Peter Brooke raised the first Advent fund, at $6.8 million for TA Associates. In 1972, Advent II was raised at $10 million. Succeeding to achieve a compounded annual rate of return in excess of 30 percent, fund raising "was the least of Brooke's problems." Advent III was raised at $15 million, Advent IV at $60 million, and Advent V at $165 million in 1983. (Wilson 1986: 102-103.). In 1985, Peter Brook established Advent International - a network of independent venture capital partnerships that during its first two years grew to comprise 14 countries in Europe and Asia. In 1987, TA Associates and Advent International managed, combined, a total of $1.3 billion. Peter Brooke, "the pioneer of international venture capital," had created the world's largest global venture capital operation. (Fortune 1987: February 2).

Opponents argue that hierarchy is an inappropriate, even dangerous form of organisation for a venture capital firm, because it removes the "check and balance" element of peer review from the decision making process. While such model leads to "two-person boards of directors", composed by the entrepreneur and the venture capitalist, there is no partnership culture to refer to when problems arise; there is, after all, "much value in democratic sharing of ideas." Another element of criticism relates to such a group's strategy of targeting an industry or technology and riding the wave: "It's like sowing a lot of seeds on very fertile soil and hoping the big ones will take care of the ones that don't grow." (Wilson 1986: 101-102.)

Conceptually, opening venture capital to financial investors (funders), via investment vehicles such as the limited-life LP fund, first brought up questions related to *incorporation* (of the business) and the *leverage* factor. Venture capital had found its way among the instruments which financial investors would consider. Venture capital vehicles had emerged as alternative investments aside from commodities, government bonds, and public stock. For enterprising individuals, venture capital was now among the businesses where one could set up a company and seek for financing that would constitute a leverage factor. As has been established above, venture capital companies in which members of management (partners) jointly hold control (over 50% of voting rights), and to which financial investors bring a leverage factor (as funders), are referred to as *entrepreneurial* venture capital companies in this study.

Conceptually - from the viewpoint of this study - a far more significant development took place when established institutions, such as government and private sector corporations, started launching their own venture capital operations run by hired managers. This gave rise to questions about *agency*. Venture capital companies in which management *does not* own control, are referred to as *institutional* venture capital companies in the language of this study. As a natural consequence, the identification of the venture capitalist - who he is - became an increasingly complicated task.

Figure 34 seeks to illustrate the spiral of institutionalisation of venture capital. Success with exiting the investments of the first fund (I) raised leads to raising a bigger second fund (II) in which the minimum investment size is bigger that in the first fund. Further success constitutes the venture capital process to transform into a *venture capital spiral* of institutionalisation.

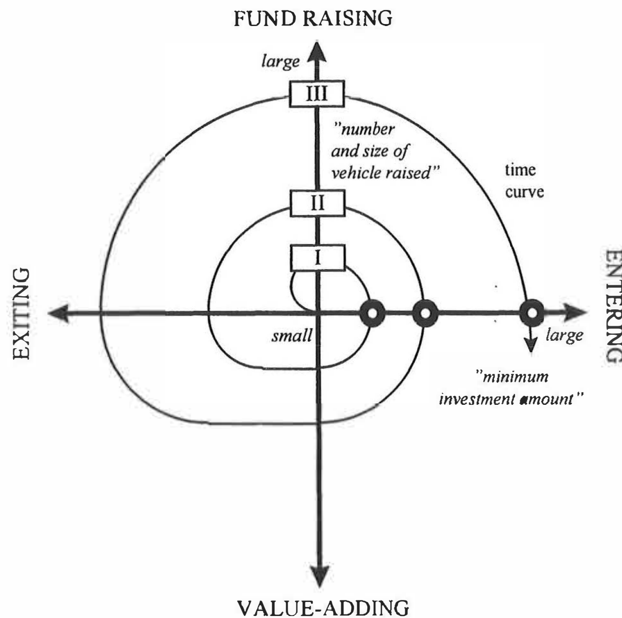

FIGURE 34 The venture capital spiral

4.2 *Institutional* venture capitalists: Persons on paper

> "The directors of such (joint stock) companies, however, being the managers rather of other people's money than of their own, it cannot well be expected, that they should watch over it with the same anxious vigilance with which the partners in a private copartnery frequently watch over their own. Like the stewards of rich man, they are apt to consider attention to all matters as not for their master's honour, and very easily give themselves a dispensation from having it. Negligence and profusion, therefore, must always prevail, more or less, in the management of the affairs of such a company." Adam Smith (1937; originally published 1776).

As discussed above, control in venture capital business is owned either by the management or outside shareholders. It can hence be concluded that venture capital is either management driven or investor driven. In the management driven structures, the venture capitalist is a natural person (or a team of national persons), whereas in the investor driven structures the venture capitalist is a legal person - a person on paper - (or a team of such persons). This chapter will provide a historical review of the evolution of the latter.

Institutional venture capitalists fall into two categories: corporate and governmental. An institutional venture capital company is labelled corporate if private sector entities (investors or businesses), jointly control the majority of votes in the firm. Respectively, it is labelled governmental, if public sector entities (national or regional) hold control. Regarding venture capital companies in which the three main owner groups - entrepreneurial, corporate, and governmental - each hold shares, and none has a majority, the venture capitalist can be identified as institutional, but labelled neither corporate nor governmental.

4.2.1 *Corporate* venture capitalists

4.2.1.1 *Independent* corporate venture capital companies - revolving seats for venture capitalists

Due to the chosen reporting strategy it has not been possible to address the impact of general Georges F. Doriot on the field of venture capital before this point. On the other hand, having already reviewed the development of the field *outside the institutional context*, it may be easier to go back in history in order to evaluate the man who gave venture capitalism its perhaps most appreciated face and, unarguably, its classic strategy logic.

The landmark of institutional venture capital activity was the founding of American Research and Development Corporation. (ARD) in July of 1946. Recruited as its president in December 1946, general Doriot served the company as its leader and guiding spirit for nearly 28 years. According to Bylinsky (1976), Doriot not only made a great personal contribution to American venture capitalism but also got it started in Europe.

ARD was established by three men of diverse backgrounds: Ralph Flanders, president of Boston Federal Reserve Bank, Merrill Griswold, director of Massachusettes Investors Trust, and Karl T. Compton, president of M.I.T. None of the founders knew how to evaluate new technological ideas but, through a synthesis of their backgrounds, they developed such knowhow. ARD chose the French born (American resident since 1921) Harvard professor and resourceful wartime Pentagon deputy director of R&D, general Georges F. Doriot, as the company's president. (Klaasen and Allen 1980: 7.)

To get ARD up and running, the three founding figures "had prevailed on the [Massachusettes Investors] Trust and other large institutions to pledge $2.5 million of a planned $5 million risk-capital pool." ARD's idea was "too far-fetched" for most investors and it barely raised the $3 million which had been set as a minimum. "It was nip and tuck whether we were going to make it" recalled an early employee later on. (Wilson 1986: 19.)

General Doriot's strategy logic

Doriot put "much more than money into new companies and expected to get much more than money out" (Bylinsky 1974: 8). He of course wanted his

portfolio companies to do outstandingly well in their field but, in his view, if they did, rewards would follow. Doriot was hence not driven by calculations for expected rates of return: "If I were a speculator, the question of return would apply. But I don't consider a speculator... constructive. I am building men and companies." (Klaasen and Allen 1980: 7.)

Doriot was brought up by a demanding father who would "spank him unless he was the first in his class." As a university teacher he is remembered for his controversial lectures on how to run a business, consisting of his personal views on life, business, and 'even on picking on a wife'. His central message was: "Understand the value of time, be intent on reaching a worthwhile goal, and drive toward it through infinite and co-ordinated attention to detail." (Bylinsky 1974: 8-9.) Doriot's classes influenced many future venture capitalists, including Thomas J. Perkins, of Kleiner Perkins Caufield & Byers: "It was an approach to the way you deal with people, an understanding of how an engineer thinks, how a financial person thinks, how the president needs to think to make them interact as a team. There was no analysis, no numbers, it was all an attitude. Some of the students thought it was just nonsense. But when I think of Harvard, I think of him." (Wilson 1986: 20.)

First and foremost, it was Doriot's job to decide where ARD would put its money. According to his famous rule "a grade-A man with grade-B idea is better than a grade-B man with a grade-A idea." In this sense, it was Doriot's key challenge to recognise 'grade-A men'; a job for which, in the words of an admirer, Doriot had "a God-given talent." According to another observer, a scientist: "I'm sure its an art - not a science. I can't tell you what Picasso's secret is either." Nevertheless, even Doriot picked wrong at times. (Bylinsky 1974: 11.) One of the secrets may have been that, as noted by Klaasen and Allen (1980: 7), "unlike J.H. Whitney & Co., ARD was always purchasing voting control in a portfolio company."

Although "Doriot's Dream Factory" (as Fortune labelled ARD) was eventually phenomenally successful, it did not start reporting gains before 1955. And even there, more than 80% of ARD's assets ended up consisting of one enormously successful venture. In 1957, ARD invested $70,000 in the start-up of Digital Equipment Corporation following a process which, according to DEC president Kenneth H. Olsen, took three months and still half the ARD staff ended up resisting the investment. DEC needed no additional capital for eight years In 1972, when DEC's shares were spun off to ARD's shareholders (in connection with merger into Textron), the investment was worth $350 million. (Wilson 1986: 19-20.)

Doriot's enthusiasm for bright entrepreneurs, however, drove him, at times, to back businesses "with little hope of commercial success." And his reluctance to write off a struggling enterprise left ARD with a considerable amount of dead wood in its portolio, by present standards. The "main flaw" in Doriot's approach, however, was elsewhere as testified by Charles P. Waite in

the excerpt below.[135] Few men, after all, are driven by a purely *idealistic* calling. Often this quality is related to the founding fathers of ideologies, sometimes it is true for businesses as well: Revolutions, they say, have a tendency to swallow their leaders.

> "ARD's biggest failing, which eventually led to a corrosive loss of talent, was its inability to adequately compensate its principals. As employees of a publicly held investment company, Doriot's disciples could not share in the gains as their investments began to pay off. 'We were involved in companies that were very successful', notes Waite 'and the people in those companies made a lot of money. But the associates at ARD, who had helped that process, didn't make anything'." (Wilson 1986: 20-21.) [136]

Wilson (1986: 21) concludes, however, that "Doriot's view of the venture capital process as a dynamic, personal relationship between investors and entrepreneurs left an indelible imprint on the emerging risk capital industry as his apprentices departed to implement his teachings in their own firms." The Chairman of Textron, the company that eventually acquired ARD, addressed the legacy of Doriot as follows (Bylinsky 1976: 22):

> "We can never duplicate - or even successfully imitate - his personality, style, wisdom, or genius. But we can, and will, do credit to his ARD concept by building upon it with the same dedication and high principles."

Klaasen and Allen (1980: 15) conclude that "the success of a venture capitalist often depends on a very close working relationship... and active involvement of the investor in the company." Due to the long-lived nature of this relationship "both sides trust and respect each other." In return for sharing equity and decision making with a venture capitalist, the entrepreneur may receive "the benefit of a rare source of informed, seasoned judgement." This is a view supported by the conclusions of Sapienza (1989).

ARD as a structural prototype of institutional venture capital company

ARD was established as a single LTD structure and, until 1960, it was the only publicly-held venture capital company in operation (Dominguez 1974: 2). For such a firm, share capital comprises the *vehicle* available for funders. Every new fund-raising exercise takes the form of an issue of new shares. Unless the prevailing group of owners that jointly controls the majority in such a company itself subscribes for shares in each new stock issue, it will ultimately lose control of the company, i.e., its position as the venture capitalist. In other words, in order for the venture capitalist to maintain his position as a venture capitalist, he must participate in every new fund raising exercise alongside the funders. Figure 35 illustrates the basic make-up of a single LTD structure (such as ARD was), presented initially in chapter 3.3.2.

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[135] Waite first served as General Doriot's teaching assistant at Harvard, then as an officer of ARD for a number of years, before co-founding Greylock & Co. in 1965 (Waite 1983).

[136] ARD's mission statement (see chapter 1.2) comes to a different light.

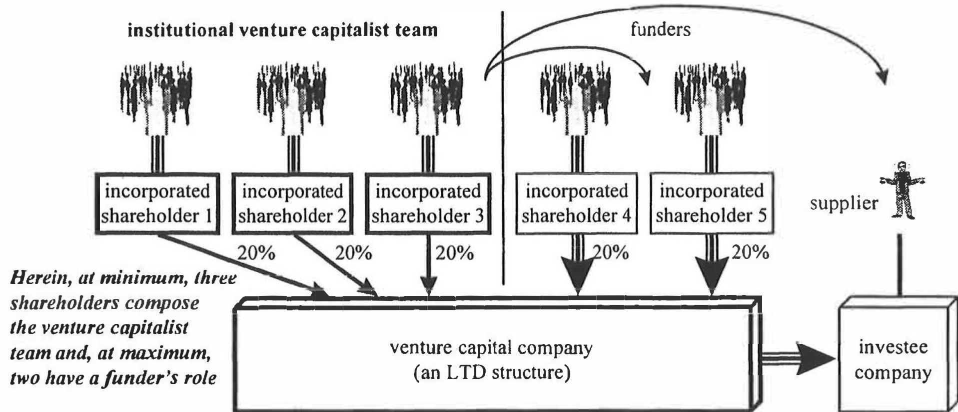

FIGURE 35 Portrait of an *institutional* venture capitalist *team* making investments *via* a single LTD structure

It is not necessarily all that easy to identify the venture capitalist in the independent corporate venture capitalist setting, in situations where no one party alone holds the majority. Often, in such cases, a relatively diverse group of investors, independent of each other, come together and establish a joint company for the purpose of venture capital investing. Venture capital companies, in which one single party controls the majority, are referred to as captive corporate venture capital companies. On the same token, if a group of parties that belong to the same financial grouping (or *keiretsu*) jointly hold the majority, such companies are to be thought of as *semi-captive* venture capital companies.[137]

Nevertheless, under the single LTD structure, successful fund raising, *per se*, can lead to a change of venture capitalist. In fact, even the *type* of venture capitalist can change, for example, from independent corporate to captive corporate. In publicly listed venture capital companies, the venture capitalist may also change as a result of active trading of existing stock but, admittedly, not without the consent of one or more of the members of the venture capitalist team. For example, in the situation of figure 35, any one of the three institutional shareholders (who jointly comprised the venture capitalist team) could cause a change of venture capitalist by selling his shares to an outside party.[138]

In fact, such a procedure even worked the end of the legendary ARD. In 1971, ARD merged with Textron, Inc., a large industrial conglomerate. Upon its

137 Often, at least outside Japan, it is very difficult to prove such strong links between companies that would make them referable to a keiretsu. In Finland, quite clearly identifiable financial interest groups existed – gathered around the leading commercial banks – until dissolved by (forced) mergers following the early 1990s recession.

138 Theoretically, the same could happen in closely-held venture capital companies that utilise the LP fund structure, but such companies could employ more effective 'protective mechanisms' (shareholder agreements, partners' rights of first refusal, etc.) than publicly-held, single LTD structures could.

merger into Textron, the net assets of ARD were valued at $428 million, up from $93 million in 1966, and a meager $3.4 million at the end of its first year in 1946. (Bylinsky 1976: 4-5.) America's pioneering corporate venture capital firm had lasted independent for 25 years. According to Klaasen and Allen (1980: 8), one key reason for the merger was that no replacement could be found for the 72 year-old *venture capital general* (see also Bylinsky 1976: 22).

Nevertheless, successful entrepreneurial venture capitalists which operate utilising the LP fund structure eventually reach the point in their development at which converting institutional resembles a call of nature. In an analogy to successful entrepreneurs who, by nature, are both expected and accepted to bring their start-up ventures from a back-of-an-envelope sketch to a public corporation, the venture capital entrepreneurs should be expected - and accepted - to bring their companies 'public'. Equally so, as societies at large have learned to lean on their entrepreneur-potential as a primary source of new competitive advantages - and not the public corporations - also their backers, the venture capitalists, should be looked at through similar eyeglasses. This is neither suggesting that established venture capitalists mean less to an economy than their challengers, however, nor suggesting that established corporations mean less than *their* challengers.

Following the increases in the number and size of funds under management and the number of partners and staff for a venture capital company, the point is eventually reached where the temptation to seek for public listing for the venture capital company becomes overwhelming. Once the majority control becomes converted from the day-to-day management to outsiders - be they institutional investors or retired partners - the venture capitalist converts from entrepreneurial to institutional.

Should publicly-held venture capital companies increase in number in the future, it does not take a prophet to project that such concentrations of power will attract greatly increasing take-over attention by various players on the market across national borders. A hostile take-over of an *independent* corporate venture capital company would most likely convert it *captive*. The possibility should not excluded, either, that *hostile foreign government-owned* acquirers emerge.

Bruno (1986: 115) points out that the concept of a publicly-held venture capital company is, actually, a "contradiction of terms." Due to the illiquid nature of venture capital investments such financial instrument is "generally inappropriate for the investing public." The following overview of experiences related to the American government's initiative, in 1980, which created BDCs (publicly-held business development companies) could almost as well be based on the experiences related to the Finnish equivalent *kehitysyhtiö* era initiative during 1984-1989 (see chapter 6.1.2).

> "The net asset value (the difference between assets at market value and liabilities, divided by shares outstanding) heavily influences the price of the stock. If a BDC is selling at a discount, an equity offering is not a viable option and borrowing money is the only solution. This drives the management philosophy and strategy towards a diversified portfolio and conservative choices. Moreover, the books of the BDCs are

> difficult to read for the shareholders. Investments in private companies are carried at values determined by the board. Equity is raised through off-balance sheet methods to avoid dilution of stockholders' equity. These considerations are probably among the reasons why Heizer Corporation and Narragansett Capital Corporation, the two largest companies of the BDC segment, left the battlefield (the first one liquidated, the second one was offered a buy-out) a few years after the new status was approved." (Bruno 1986: 115.)

Narragansett Capital Corporation had reportedly noted with concern the industry's tendency towards "strictly qualitative" measures in evaluating investee management. Says Barber (1983), the company's VP New Investments since 1978: "We have tried to augment our own judgement (often called 'gut feeling') with a quantitative review of the [investee] management... Management analysis can be a very difficult procss. We feel that while 'gut feeling' or the 'right chemistry' are important factors, the outside investor should have hard data to support convictions about management."

Efforts to quantify and systematise the venture capital investment process have been a natural evolution, given the extent to which institutionalisation and managerial professionalism have progressed in the venture capital industry.[139] Venture capital, however, may be as impossible to capture in a model as is entrepreneurship. But as for entrepreneurs, tools should be developed for venture capitalists as well; in the spirit of Plummer (1987): "Venture capitalists must value companies every day, but almost none has tried to write down how they do it. Venture capital has been an 'apprenticeship industry'. The only way to learn it has been by working for or with an old hand in the industry. However, many of the old hands are a little shy on financial analysis skills. With the venture capital field growing so fast, there is a need for a compilation of the rules of thumb in common use in the industry. There is also a need to try to reconcile those rules of thumb with modern financial analysis techniques."

Hisrich and Jankowitz (1990) constructed a new method - embedded in construct psychology - to study the intuition in venture capital decisions, and entered into the interesting proposition that venture capitalists may differ from bankers because of the way venture capital firms are structured: Venture capitalist and the investee entrepreneur operate on a same 'CEO level' - in the same 'world' - whereas the banker operates within a different framework altogether. The venture capitalist shares the concerns of the entrepreneur, whereas the banker (if only due to his different institutional reality) remains more distant. To William P. Egan, a Boston-based venture capitalist, the difference between a banker and a venture capitalist is "the difference between dating a girl and marrying her" (Fortune 1987: February 2).

4.2.1.2 *Captive* corporate venture capitalists: Arms of corporate strategy

> "Toward the end of the 1960s American businessmen developed one of their periodic infatuations with a new management tool. By creating new ventures divisions, as many of these organisations styled themselves, big companies hoped to stimulate external investments and internal entrepreneurship that would catapult

139 Siskos and Zopoudis (1987) is one example.

> them into exciting new growth areas. Within a few years, however, virtually all of the venturing groups were out of business with little to show for their efforts." (Wilson 1986: 149.)

Venture capital companies, majority-owned by only one private sector entity, are referred to as captive corporate venture capital companies.

The origin of the captive type has its roots in the intensifying competition between industrial corporations in established businesses. In the post-war period, during which successful venture-backed, high-tech-based entrepreneur-driven start-ups became an established phenomenon, large corporations discovered that they lack the entrepreneurial spirit and drive necessary to produce competitive innovations. As a result thereof, they came up with the *corporate venturing* idea.

Strategy logic

Henderson (1988: 260-261) accounted the increase of corporate venturing activities for a window the venture capital process offers on the "traditionally slow-moving development programmes" of large companies. In his view, corporate venturing units may invest much more money in emerging business than do private venture capitalists, if only the technology and the market are right. Also, captive corporate venture capitalists can provide technical assistance and quick access to lucrative markets.

The typical *captive corporate venture capital company* is an arm of a parent corporation, established to pursue the parent's strategic interests rather than direct financial gains as an independent business. Many large corporations have, since the 1960s, had their wholly-owned corporate venturing units which invest in 'group-strategically' interesting ventures.

The corporate venturers learned the hard way that this is dealing with a long-term vehicle. Some of the early-bird disappointed ones included General Electric, Ford, and Monsanto. (Wilson 1986: 149).[140] Shames (1974: 117) lists also Alcoa, Boise Cascade, Coca-Cola, General Mills, International Paper, Mobil Oil, Travellers Insurance, Singer, U.S. Steel, Dow Chemical, 3M Company, and Exxon as companies that had set up new venture and venture management groups. Roberts and Berry (1985) list Du Pont, Singer, and Union Carbide among the pioneers of the art.

According to Bruno (1986), captive corporate venture capital companies have a "philosophy problem" when compared to entrepreneurial venture capital companies. Testifies an ex-Xerox venture capitalist (Rind 1983): "Corporate venture capitalists can be good partners. However, it is important to note that there have been many abrupt terminations of such activities by the parent corporations; several despite excellent returns. In fact, no strategically oriented corporate venture capital group has succeeded in keeping its key

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[140] For more on the challenges of corporate venturing, see Hardymon, DeNino, and Salter (1983).

personnel for more than seven years." Figure 36 illustrates the basic make-up of this venture capitalist type.

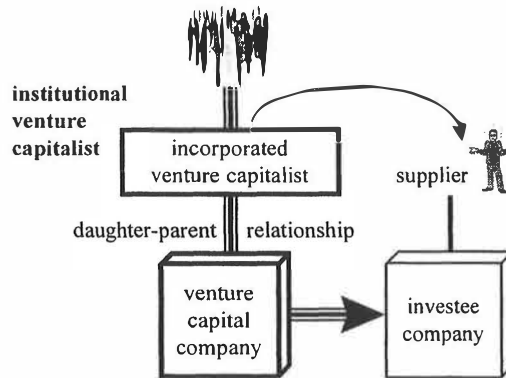

FIGURE 36 Portrait of an *institutional* venture capitalist making investment *via* a single LTD structure

Through a significant learning process (see, e.g., Sykes 1990), captive corporate venture capitalists have returned to the field stronger than before. Nokia Corporation makes a good example of the new breed of captive corporate venture capital operations, having incorporated its venturing activity into a setting that utilises the limited-life LP fund structure. Such an approach can be seen as 'coming down the tree' for the captive corporate venture capitalist.

Also *governmental* venture capital companies, in most cases, are captive to a single owner. And the public sector single-owners - just like their private sector peers - are expectedly after indirect, strategic objectives. The main difference between the private and the public sector single-owners is that, while captive corporates are missioned to seek 'food' for their parent companies, their governmental colleagues are genuinely set out to seek and build new independent corporations.

4.2.2 *Governmental* venture capitalists

The initial call for venture capital in America, in the late 1930's, already emphasised the role of venture capital as an important *economic input* (Reiner, 1989: 1). From those early days, government policies have had a major impact on the development of the venture capital industry. Tax reforms, especially changes in capital gains tax rate, and liberalisation of institutional investing and securities legislation (Reiner, 1989: 94-107) have traditionally been used to activate venture capital investing.

In particular, the 1942 tax reform (Reiner 1989: 95), the 1958 SBIC Act (Bruno 1986: 114), the 1978 and 1981 capital gains tax rate reductions, and the adjusted ERISA ruling in 1978 have influenced the structure and development of the venture capital industry. Together with the IPO market activity and

cycles in the economy the above have strongly moved the industry. (Bygrave 1989: 156-157).[141]

4.2.2.1 The story of Europe

In its editorial on 27 December 1999, the Business Week magazine gave Europe's general status quo the following appraisal:

> "Europe, with its history of kings, kaisers, and despots, is proud of the social progress of the last century. Its citizens are reluctant to toss these gains aside for the promise of the New Economy. They like their long vacations, and those with jobs consider high taxes and modest growth a tolerable trade-off... Continental politicians may believe they can muddle through to the next century and they could be right. The markets may do all the heavy lifting for them. But without favourable government policies promoting growth, rather than stifling it, Europe will probably not reach its economic potential anytime soon. And the best and the brightest of its children will continue to seek their opportunities in London, New York, and Silicon Valley."

According to Tyebjee and Vickery (1988), "entrepreneurs and small businessmen have not been accorded high social status [in Europe]. Career advancement within the large corporation is the desirable path to business success." Europe has a significantly lower business birth rate per capital than America as a reflection of its less developed entrepreneurial culture. In a recent study it was established that, within Europe, *Finland* has the lowest business birth rate. Since the UK is often referred to as Western Europe's 'odd-one-out', when closeness to American enterprising culture is measured, and Finland is now (based on this one measure) discovered to be Europe's other extreme, it would be tempting to conclude that the cold war stand-off (buried with the USSR in 1991) affected market evolution also in the West.[142]

> "Throughout the post-war years, until the economic crisis of the mid-1970s, the dominant economic logic encouraged bigness and social forces expected security of employment. As a result, small business was seen as a temporary activity, indulged in only by those not good enough to run larger firms. Since it was temporary, it was also risky. A drive towards egalitarianism, much stronger in Northern Europe than around the Mediterranean, restricted wealth accumulation through taxation and social pressures." (Tyebjee and Vickery 1988.)

It is increasingly acknowledged that, in terms of venture capital activity, general market conditions and entrepreneurial culture are, historically, less developed in Europe vs. America. For the Americans it is more natural to

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141 The rapid reaction of the venture capital firms to incentives and willingness for strategic change are signs of flexibility and - in the language of transaction cost economics (Williamson 1988) - lack of dedicated assets. This also indicates opportunistic behavior, and is descriptive of the "to make money" motto of the venture capital industry. Thus a major characteristic of the venture capital concept is preparedness for structural and strategic change.

142 Observations of Finnish 'enterprising development' after the country's EU membership in 1995, strongly support such interpretation - both with regard to market mechanisms and cultural aspects.

dream of creating big business and personal wealth. There is a rich history of self-made men to lean on, a large efficient single market, as well as an embraced tradition of wealthy and experienced individuals to commit themselves to backing and supporting young entrepreneurs on their way to creating new corporate stars.

In contrast, in Europe, the national markets are heterogeneous, at least in terms of culture and language, and are, historically, composed of competing nations and nationalities - all aspects severely challenging the realisation of venture capital activity's full potential on a pan-European level. In this light and regard, it is easy to note that efforts towards a single currency and cross-border EU initiatives in terms of venture capital industry development - as opposed to strictly national ones - are steps to the right direction. As pointed by Tyebjee and Vickery (1988), Europe has been rebuilt, after the war, "on guided capitalism" with which concept they refer to "the co-operation of government, large industry, and labour unions."

Apart from the market's lack of coherence, when compared with America, the heritage of entrepreneurial history is different in Europe. In America, rapid creation of big business and extensive personal wealth by enterprising individuals has been a cause for national heroism, whereas in Europe such admiration and appreciation has rather been placed on composers, authors, and poets,. On the old vs. the new continent, social status has been inherited for life, and economic structures - dating back hundreds of years - have been slow to develop. In contrast, in America, almost everything was built, literally, over the past century: Starting with the conquest of the Wild West. Europe simply has neither America's historical supply of revolutionary entrepreneurs nor their accepting capitalist backers.[143]

Whereas private ownership of the firm had faced "virtually no challenge" in America, where - instead - "a restoration of shareholder influence as one of the cures for managerial misbehaviour" had been called for, Ansoff (1982: 90-92) outlines how "in Western Europe the focus has been on modifying both the ownership and the internal power structure of the firm." He continues:

> "This difference is in part, due to the fact that many European post-war governments, rooted in the socialist ideology, do not recognise the principles of sanctity of private property and freedom of individual initiative which are still strongly held in [America]. In part, the difference is due to the fact that in Europe the firm has never become the key social institution, as it had in [America]. As a result, while many of the reforms proposed in [America] are addressed to restoring shareholder influence over management, European governments and unions have been reshaping both the ownership patterns and the power distribution within the firm... The trends in Europe are diverse, but all are strongly influenced by various socialist doctrines which do not accept private property as an ideological cornerstone. A feature which is common to all of these efforts is that the *firm is being changed from a purely economic to a socio-economic instrument of society."*

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143 The Fortune (1987: February 2) article on Peter Brooke's "drive to 'internationalise' venture capital" addresses the challenge by concluding that - thanks to the rigid, bureaucratic corporations of Germany, France, and Japan - "potential entrepreneurs, the raw material of venture capitalists, are scarce abroad."

Patricof (1989) addresses the lack of "recent tradition of entrepreneurial risk taking" as the main hindrance of the emergence of venture capitalism in the UK versus America, let alone the rest of Europe versus America: Lifetime employment was valued over entrepreneurship. He notes that Europe is approaching a point after which the possibilities for venture capitalists are "intriguing;" referring to the upcoming removal of financial and market barriers at year end 1992 in creation of the European single market. "A product can be financed in one country, manufactured in another, and marketed in a third. Companies will not be merely French or Italian, any more than companies in Philadelphia or Los Angeles are merely Pennsylvania and California companies." [144]

The EVCA, established with 43 members in 1983 had by 1987 grown to comprise more than 170 members in 21 countries. During this time, in France, the industry grew from "virtually nothing to more than 70 venture capital firms managing more than £1 billion of funds." (Euromoney 1988: January).

Ten years later, much of the development envisioned by Patricof (1989) taken place, and another phenomenal growth wave of the industry taking place, similar expectations can be attached to the upcoming single currency; business will become increasingly pan-European (cross-border within the EU) and the possibilities for venture capitalists are only the more exciting. Whereas Patricof (1989) could make the note that a number of countries had began to "create the atmosphere needed for venture capital to grow," it can now be noted that Europe as a whole - as a single market - is off to a good start in creating such atmosphere.

4.2.2.2 *National* governmental venture capital companies: Tools of economic policy

The venture capital process was imported from America to Europe largely on a governmental initiative in the late 1960s. In Finland, France, and Sweden, for example, government-owned venture capital companies were the first renowned industry structures and long the dominating players. General Doriot and the ARD model had a significant influence in getting venture capital imported to Europe (Klaasen and Allen 1980: 8; see also Bylinsky 1976).

Governments typically establish either wholly-owned LTD structured venture capital companies (as portrayed in figure 36 above) or similar structures in which they would hold majority control, but also invite private sector entities to participate. During the past ten years, governments have also engaged in companies which utilise the LP fund structure. Figure 37 illustrates

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[144] The Euromoney magazine (1988: January) reviews the build-up of venture capital in Europe: "The story begins at the end of World War II. Industrial Europe lay in ruins. Huge sums of capital investment were required to rebuild shattered companies. Enter the banks... There ensued decades of stability and profitability, in which private family-owned companies became the industrial backbone of West European economies. They did so under the comfortable and helping wing of house banks. As a result, their industrial growth was phenomenal. They remained, however, deprived of sophisticated financial advise."

a case of a 50-50-owned joint venture between a private sector entity and a public sector entity: An LTD structured venture capital company utilising the LP fund structure.[145]

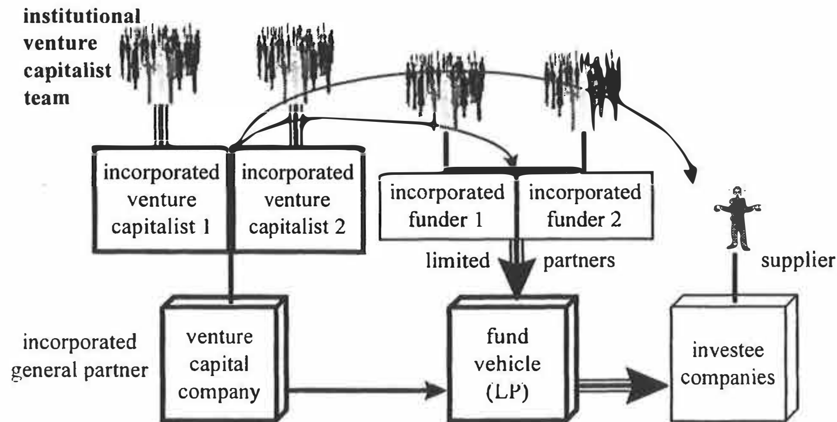

FIGURE 37 Portrait of an *institutional* venture capitalist *team* making investments *via* an LTD-structured venture capital company *utilising* the LP fund structure

It is difficult to imagine sensible competition between a governmental and an entrepreneurial venture capitalist. To survive, the entrepreneurial venture capitalist has to earn a competitive financial return from his investments, whereas it is *sometimes* enough for his governmental competitor to get funds invested. In head-on competition between the two types, the governmental player can always 'sell his capital cheaper' and require less covenants than his entrepreneurial competitor (as long as the entrepreneur understands his loss of control as linearly correlating with the price of capital).

It takes a very sophisticated entrepreneur to understand that he might in fact be better off with a more demanding, more ambitious venture capitalist - if the goal is to *build* business. The notion *turns around* the direction of correlation between the venture capitalist's active role in governance and the perceived price of the money offered: The venture capitalist who invests more time (in governance) alongside the money may, in fact, offer a better deal than the one who is practically giving it away. Unless, of course, the true motive of the entrepreneur is of the 'take-the-money-and-run' kind.

No one denies the importance of parenthood in bringing up children to how they will be when adults; and whether they will survive, in the first place. There is only disagreement on what *ideal* or *good* parenting is. In today's world of difficult-to-find ideological dividers between politicians (and people in general), one such is right here. To one extreme, ideal parenting takes place at

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145 The EBRD, for example, has employed such private-public partnerships in its venture capital fund programmes for the markets of Eastern Europe.

home by a married husband and wife, whereas it involves institutional care-taking and any combination of parents to the other. [146]

In the world of business, *ownership* is the force resembling parenting in bringing up young companies. Ownership is important as to how they will be when established, and whether they will survive, in the first place. And there is the same ideological divider: Some emphasise harsh individual upbringing under free enterprising principles, while others pursue more collective involvement and control.[147]

> "A two-person unit is the best 'owner' of a child, I think. Communications satellite, on the other hand, requires governmental joint ownership. These are the two extremes. According to my understanding, ownership should belong to the party that has the maximal ability and motivation to control the object. Economists tend to think that small business entrepreneurs are automatically greedy and thus potential employers. I doubt that. Many entrepreneurs have lost motivation to become rich, and employing only oneself plus possibly the family feels more pursuable." Raimo Puisto, a Finnish entrepreneur (Fakta 4/1991).

4.2.2.3 *Regional* governmental venture capital companies: A path of trial and error

Even regional governments, such as municipalities and counties - both in America and Europe - before long discovered the potential tool value of a venture capital company to their local economic policy interests. Sometimes such companies were established as local 'private-public partnerships' where private sector entities participated as co-founders and shareholders of the new regional policy vehicles - typically established as single LTD structures.

Beste (1983) presented Community Development Corporations (CDCs) as little known sources of venture capital that had been on the market for ten years already. The keys to attracting financing from such an organisation are "a convincing business plan and being in the right place (or willing to go there)." According to Beste, "CDCs are not in the game solely for the financial reward. While they would like to be able eventually to sell their investments at a profit to enable them to reinvest these funds in several new businesses, their performance is measured in various ways other than profitability." Among the disadvantages of dealing with a CDC, Beste lists their moving more slowly than venture capitalists. This observation, given their smaller concern for

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146 A 'normal' child prefers less parental control and, according to some upbringing principles, should be raised (more or less) without such. In the view of many others, a child will be spoiled unless trained to harsh reality and the 'laws of nature' by *demanding,* yet loving, parents.

147 Political voices have been raised within the EU, demanding that market forces be brought under a stricter political control - not least due to short-term shareholderism (service of shareholders at the expense of other stakeholders, the environment, and society at large). Interestingly enough, and justifying some concern, the ownership of the world's largest companies is almost as dispersed as it was of companies in the USSR, the poor governance of which brought down the entire experiment. During the late 1980s, when managerial revolution ('absentee parenting') pushed corporate diversification at peak, 'LBO associations' emerged as tools to enable takeover revolts and restoration of owner control (hands-on parenting).

profitability, suggests that the CDCs work less efficiently, let alone less aggressively, than their private-sector peers.

Sandberg (1988) discovered that CDC staff members typically have prior experience from venture capital, consulting, and investment banking. Regardless of the fact that they were offering services for little or no cost to their client firms, a significant percentage of their investees failed. Sandberg (1988: 15) continues as follows: "It may be that CDCs invest, for socio-political reasons, in less attractive prospects than do venture capitalists. But CDSs purport to offer their clients a full range of financial and management services (the latter usually at no charge) of the type usually provided by venture capitalists. If these were indeed the critical determinants of new venture performance, one would expect CDC-backed ventures to perform more or less as do those backed by venture capitalists."

While Sandberg (1988: 15) points at the differing selection criteria (*strategy*) as the main source of different investee performance between CDCs and venture capital firms, in the perspective of this study the *ultimate* source of difference between the two is *ownership*.

4.3 Family tree of the venture capitalist

Two major forces have dominated the evolution of the venture capital industry to-date, *institutionalisation* and *globalisation*. Globalisation means both the export of *venture capital* from America to Europe (and elsewhere in the world) and the birth of international venture capital companies. Institutionalisation refers to the growth of the capital pool managed and, consequently, organisation of the average venture capital company.[148]

TABLE 8 Types of venture capitalists

	private sector venture capitalists	*public sector venture capitalists*
institutional venture capitalists	captive corporate	regional governmental
	independent corporate	national governmental
individual venture capitalists	entrepreneurial	*(empty zone)*
	private	

148 Partricof (1989) addresses the *internationalisation* of venture capital and Rogers and Miglani (1988) the *globalisation* of the entire financial services industry. Seppä (1997) ponders upon the effect of the two factors to venture capital in emerging economies.

In conclusion, the family of venture capitalists comprises of two 'clans', *individuals* and *institutionals*, and sub-segments within each. The individuals fall into *privates* and *entrepreneurials* and the institutionals into *corporates* and *governmentals*. The corporates can be further divided into *independents* and *captives*, and governmental venture capitalists into *national* and *regional* ones. Table 8 illustrates the make-up of the field emphasising the two important dividers: individual vs. institutional and private sector vs. public sector.

Another perspective on the owner-types is whether it involves a single-owner, a team of owners, or dispersed ownership. There has been research interest recently to study team entrepreneurship vs. the (classic) sole entrepreneurship. In venture capitalism, too, both can be identified. Private venture capitalists (business angels) are, by definition, 'their own men' - independent wealthy individuals. Captive corporate venture capital companies also have a single-owner as venture capitalist. The same applies to practically all national governmental venture capital companies. Entrepreneurial and independent corporate venture capital companies have, by definition, teams of either individuals or institutions as their controlling owners.

Private venture capitalists (business angels) often invest on their own personal account without the bureaucracy and costs of a formal company. Entrepreneurial venture capitalists typically set up separate LP fund vehicles to protect against dilution of ownership. A single LTD structure - run by hired management - is the natural choice for institutional venture capitalists. Increasingly, however, institutional venture capitalists establish venture capital firms as management companies of LP fund structures. It makes the raising of outside capital - the leverage factor - an option even for them. Given their tendency to pursue hidden agendas, it is uncertain whether they become established as a permanent niche vehicle among the alternatives the industry offers to funders. In chapter 3, 'pigeonholes of ownership' were crafted for the venture capitalists. In the present chapter, the founding archetypes of strategy logic have been examined. The two are being merged with help of figure 38.

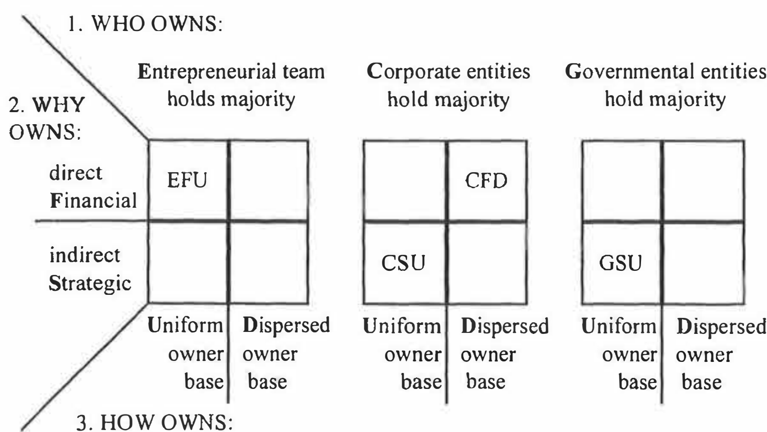

FIGURE 38 Venture capitalists in pigeonholes of ownership

Figure 38 depicts venture capitalists in basic pigeonholes of ownership. The illustration serves as a tentative typology of venture capitalist strategy logic emphasising the ownership issues. Entrepreneurial venture capitalists ('E'), typically followers of Greylock & Co. (venture capital firms utilising the LP fund structure), are concluded to pursue directly financial purposes ('F') and to operate on a uniform owner-base ('U'). They are placed in the 'EFU' pigeonhole in figure 38. Corporate venture capitalists ('C') fall into two categories. Independent corporate venture capitalists, typically followers of ARD (publicly-held venture capital firms utilising a single LTD structure), are concluded to pursue directly financial purposes ('F') and to operate on a dispersed owner-base ('D'). They are placed in the 'CFU' pigeonhole. Captive corporate venture capitalists are concluded to be after indirect strategic gains ('S') and to operate on a uniform owner-base ('U'); placed in the 'CSU' pigeonhole. Governmental venture capitalists (G) are concluded to be after indirect strategic gains ('S') and to operate on a uniform owner-base ('U'), placed in the 'GSU' pigeonhole.

In figure 38, an arrow points at the direction of evolution that has been witnessed in venture capital going from entrepreneurial towards increasingly institutional ownership, from uniform to more dispersed owner-bases, and from strictly financial towards more complex, indirect strategic purposes.

By now, everything is ready for depicting it all in a family tree. Figure 39 presents the evolution of the venture capitalist community *climbing up* the tree. Once through with chapter 5, they will be followed *climbing down*, in chapter 6.

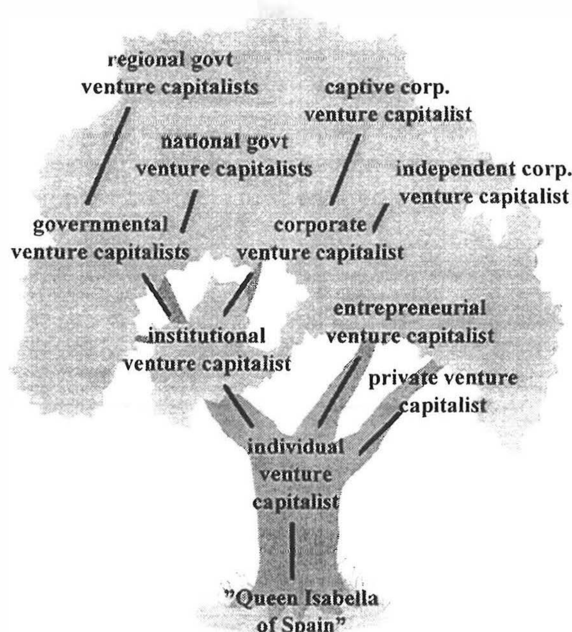

FIGURE 39 Family tree of the venture capitalist

5 ARCHETYPES OF STRATEGY LOGIC: SEEKING EVIDENCE FROM INDUSTRY SURVEYS

In this chapter, the results of the survey exercise are presented and discussed. In Finland, three surveys were conducted, while only one was conducted in America. For the purpose of the present study, the respondent firms were classified as either entrepreneurial, corporate or governmental. The study of *governmental* firms can only draw from the Finnish surveys but the effort benefits from a good degree of comparability of samples. There is a corporate sample in each of the four surveys, but these are more heterogeneous samples and (hence) a degree less comparable with each other. Although the study of entrepreneurial companies can only draw from the one American survey, it is the largest and the most homogeneous of the eight samples.

The construction of the survey questionnaires (appendices 3-5) follows the stages of the venture capital process and, at several instances, uses variables and measurements created by earlier venture capital studies (e.g., Sapienza 1989). Because the focus, herein, is in the analysis of differences between differently-owned venture capital companies, it has not been the aim to compare the findings of the present study and such earlier studies.

5.1 Introduction to the surveys

The survey exercise consists of three independent research efforts: Finland 1989, Finland and America 1992, and Finland 1997. For Finland, at each point of time, all organisations that could be identified as venture capital companies were included in the survey population. In other words, whereas the American survey population was derived from an established industry data bank, the Finnish populations are the product of the researcher's own analysis of the players of the field. In 1989, the venture capital company population of Finland was defined at 48 companies (of which 82% responded to the survey). In 1992,

the population was defined at 39 companies (of which 74% responded) and, in 1997, at 30 companies (of which 70% responded). The American sample consisted of 718 North American companies (of which 9.3% responded).

As this research project was not planned to last through an entire decade, none of the surveys were (in fact) planned to be repeated. Instead, each of the surveys built on an increased understanding and enhanced conceptualisation of the target phenomenon. The three surveys conducted in Finland during 1989-1997 bring, nonetheless, *a longitudinal element* to the investigation.

The 1989 survey was conducted to produce data for Seppä (1989). In November 1988, a questionnaire was sent to CEOs of 55 organisations identified as venture capital firms in Finland (appendix 3).[149] Each recipient was called in person to discuss the research and the status of their business. Eight firms became thereby excluded as venture capital firms, because they were either not yet (legally) established or were not actually engaged in the business examined. The total sample, defined as the entire population in Finland for the time being, was thus 48 companies of which 40 had responded. Results of the 1989 survey have been previously reported in Seppä (1989) and Seppä and Näsi (1991). Altogether 34 respondent firms qualified for the present analysis. Three became omitted due to incomplete answers and another three due to comprising too small a group for an entrepreneurial sample.

In 1992, another questionnaire was prepared and sent to CEOs of 39 venture capital companies in Finland and 718 firms in North America (appendix 4). Both surveys enjoyed the moral support of (industry associations) EVCA, FVCA, NASBIC, and NVCA. The Finnish sample was defined as in 1989 and considered to represent the entire population in Finland for the time being. The North American sample consisted of companies listed in the 1992 edition of *the Pratt's Guide to Venture Capital Sources*[150]. Although far from conclusive (for an entire population defined as for Finland), the sample can be considered representative of the industry in North America for the time being. In America, Venture Economics, Inc. served as the mail centre for the survey. Results of the 1992 survey have been previously reported in, e.g., Seppä, Näsi, and Reynisson (1992). Altogether 25 of the original 29 responses of the Finnish survey qualified for the present analysis (four had to be omitted due to comprising too small a group to be used as an entrepreneurial sample). Of the 67 North American respondents, a total of 44 qualified for the present analysis. One third were omitted either due to incomplete answering or for being Canadian.

The 1997 survey questionnaire was prepared to serve two independent research projects and sent to CEOs of 30 venture capital companies in Finland (appendix 5). The sample was defined, as in 1989 and 1992, as the entire population in Finland for the time being. The results of the 1997 survey have been previously utilised, e.g., in Seppä (1997). Of the 21 respondents, as many

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149 Companies labelled *kehitysyhtiö* (e. development company) until the late 1980s in Finland.

150 This renowned publication by Venture Economics, Inc. was (until the time of the survey) referred to by authorities as the *encyclopaedia* of the venture capital industry (in America).

as 19 qualified to be utilised in the present analysis. Two became excluded for comprising too small a group to be used as an entrepreneurial sample.

Altogether, the study derives from four industry surveys, a total of 122 filled-in questionnaires of which 78 are from Finnish and 44 from American respondents. The 78 Finnish responses represent 51 different companies, of which 4 responded in all three surveys, 19 in two surveys, and 28 in one survey.

Table 9 provides information on the four industry surveys highlighting the differences between the Finnish and the American respondent firms.

TABLE 9 Longitudinal summary information on the survey data (1989, 1992, 1997)

SAMPLE PROFILES	**1989** *Finland*	**1992** *Finland*	**1997** *Finland*	**1992** *America*
Venture capital firms	**n 34** *(100.0%)*	**n 25** *(100.0%)*	**n 19** *(100.0%)*	**n 44** *(100.0%)*
Entrepreneurial firms	0 *(0.0%)*	0 *(0.0%)*	0 *(0.0%)*	35 *(79.5%)*
Corporate firms	21 *(61.8%)*	15 *(60.0%)*	8 *(42.1%)*	9 *(20.5%)*
Governmental firms	13 *(38.2%)*	10 *(40.0%)*	11 *(57.9%)*	0 *(0.0%)*
Year founded				
-1980	3 *(8.9%)*	1 *(4.0%)*	2 *(10.5%)*	9 *(20.5%)*
1981-1985	21 *(61.8%)*	9 *(36.0%)*	3 *(15.8%)*	25 *(56.8%)*
1986-1990	10 *(29.4%)*	14 *(56.0%)*	6 *(31.6%)*	9 *(20.5%)*
1991-	0 *(0.0%)*	1 *(4.0%)*	7 *(36.8%)*	1 *(2.2%)*
Vehicle offered				
LP fund vehicles	0 *(0.0%)*	7 *(28.0%)*	5 *(26.3%)*	36 *(81.8%)*
A single LTD firm	34 *(100.0%)*	18 *(72.0%)*	14 *(74.7%)*	8 *(18.2%)*
Funds under mgmt	(founders equity)	(total funds committed)	(total funds committed)	(total funds committed)
x < $1 Million	21 *(67.7%)*	5 *(20.0%)*	4 *(21.1%)*	0 *(0.0%)*
$1 M ≤ x < $10 M	10 *(32.3%)*	14 *(56.0%)*	5 *(26.3%)*	7 *(17.9%)*
$10 M ≤ x < $40 M	0 *(0.0%)*	5 *(20.0%)*	7 *(36.8%)*	15 *(38.5%)*
$40 M ≤ x	0 *(0.0%)*	1 *(4.0%)*	3 *(15.8%)*	17 *(43.6%)*
(n.a.)	(3)	(0)	(0)	(5)
Staff total				
1-3 people	12 *(44.4%)*	16 *(64.0%)*	n.a.	12 *(27.3%)*
4-6 people	12 *(44.4%)*	5 *(20.0%)*	n.a.	18 *(40.9%)*
7- people	3 *(11.1%)*	4 *(16.0%)*	n.a.	14 *(31.9%)*
(n.a.)	(7)	(0)	(21)	(0)
Of which managers				
1-2 managers	n.a.	14 *(56.0%)*	8 *(44.4%)*	12 *(27.3%)*
3-4 managers	n.a.	7 *(28.0%)*	5 *(27.8%)*	17 *(38.6%)*
5- managers	n.a.	4 *(16.0%)*	5 *(27.8%)*	15 *(34.1%)*
(n.a.)	(34)	(0)	(1)	(0)
Manager experience		(respondent personal)	(average in the firm)	(respondent personal)
< 5 years	n.a.	12 *(57.1%)*	6 *(35.3%)*	4 *(9.1%)*
5-10 years	n.a.	8 *(38.1%)*	8 *(47.1%)*	22 *(50.0%)*
10 < years	n.a.	1 *(4.8%)*	3 *(16.7%)*	18 *(40.9%)*
(n.a.)	(37)	(4)	(2)	(0)

The 1992 survey results suggest that the industry perceives itself to be more mature in America than in Finland. According to a significant majority of the American respondents, the *industry* in America had (by 1992) either reached or passed a 'shake-out' stage, whereas a significant majority of the Finnish respondents found theirs in a 'growth' stage at best. A significant majority of

the American respondents positioned their *company* at or pass a 'growth' stage, whereas a significant majority of the Finnish respondents positioned theirs at an 'early' stage (see appendix 6: Table A).

The differences between the American and the Finnish respondent firms are to be kept in mind when evaluating the generalise-ability or (quantitatively founded) *scientific merit* of the archetypes constructed in the study. The vast differences in the operational environments should be somehow controlled when comparing the responses of, e.g., the American entrepreneurial venture capital companies and the Finnish governmental ones. In this study, no such controls were pursued, however. Yet it is quite possible that differences in the environment could be found to explain differences in strategy logic even more than differences in owner type. On the other hand, it is also possible that differences in environment primarily explain differences in the venture capitalist types which, again, primarily explain differences in strategy logic.

Table 10 repeats the primary research questions of the study – the questions that have guided the research process from its very beginning. Each of the questions will be separately addressed in the course of chapter 4.

TABLE 10 Primary research questions of the study repeated

The study examines businesses employing the venture capital process. The search for *venture capitalist strategy logic*, and archetypes thereof, addresses the following guestions:

- Who establish and own venture capital companies?
- Why do such parties establish and own such companies?
- How do the different parties own and govern their companies?
- How are the differently-owned companies organised for business?
- What economic value-added do the companies primarily seek to produce?
- Who are the ultimate customers of the differently-owned venture capital companies?

5.2 Addressing the basic ownership questions

5.2.1 Owners: Who own venture capital companies?

In this study, the *judicial owner of control* of a venture capital company (rather than the one who controls it in practice), is identified as the venture capitalist. Hence, the managers of a venture capital company are referred to as venture capitalists, in this study, only if they *legally own control* in their venture capital company.

Looking at the owners of venture capital companies through the survey windows, it is safe to start by noting that, in America, the managers themselves are venture capitalists more often than in Finland. It is equally safe to continue that, in Finland, government is (relatively) a more active venture capitalist than in America. Nonetheless, each of the parties identified as venture capitalists in

chapter 4 are to be found among the owners of the respondent venture capital companies. Next, an overview of the samples is provided from the owner perspective. Importantly, the classification by owner type of the respondent companies (as explained below) produces the independent variables of the statistical survey analyses.

Of the 1989 Finnish survey, after excluding 3 entrepreneurial respondents due to inadequate number, 34 respondents qualified for the present analysis. Of the ones qualified, 12 were classified as *independent corporate*, 9 as *captive corporate*, 7 as *regional governmental*, and 6 as *national governmental venture capital companies*. Due to the small number of respondents in each of these categories (smaller yet in the 1992 and the 1997 surveys), the regional governmental and the national governmental companies were merged into one group, and the independent corporate and captive corporate companies into another group.[151] Hence, the final samples consist of 21 corporate and 13 governmental venture capital companies.

Of the 1992 Finnish survey, after excluding 4 entrepreneurial respondents due to inadequate number, 25 respondents qualified for the present analysis. Of the ones qualified 7 were classified as independent corporate, 8 as captive corporate, 4 as regional governmental, and 6 as national governmental. After their combination, as above, the Finnish samples consist of 15 corporate and 10 governmental companies.

Of the 44 companies of the 1992 American survey that qualified for the present analysis, 35 were classified as entrepreneurial, 3 as independent corporate, and 6 as captive corporate. After the combination of the independent corporate and captive corporate categories, the 1992 American samples consist of 35 entrepreneurial and 9 corporate respondents.

Of the 19 companies of the 1997 Finnish survey that qualified for the present analysis, 4 were classified as independent corporate, 4 as captive corporate, 3 as regional governmental, and 8 as national governmental. After the combination (and the exclusion of 2 entrepreneurial respondents) as above, the 1997 Finnish samples consist of 8 corporate and 11 governmental respondents.

Figure 40 illustrates the breakdown by owner type of the three Finnish industry surveys (the percentage the survey respondents each year represent of the estimated total population appears in brackets below each column).[152] The figure also includes the entrepreneurial respondents that had to be excluded from the final analyses due to their inadequate number as a main category, as explained above.

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[151] Having to combine the independent and the captive corporate companies into one category was particularly unfortunate, since these two are expectedly very different by strategy logic. The combination could not be avoided, however, due to the small number of respondents (which only decreased for the surveys to come).

[152] In 1989, the total population was estimated at 48 companies of which 40 responded but only 37 (or 77%) could be classified by owner type. In 1992 and 1997, each respondent could be classified by owner-type.

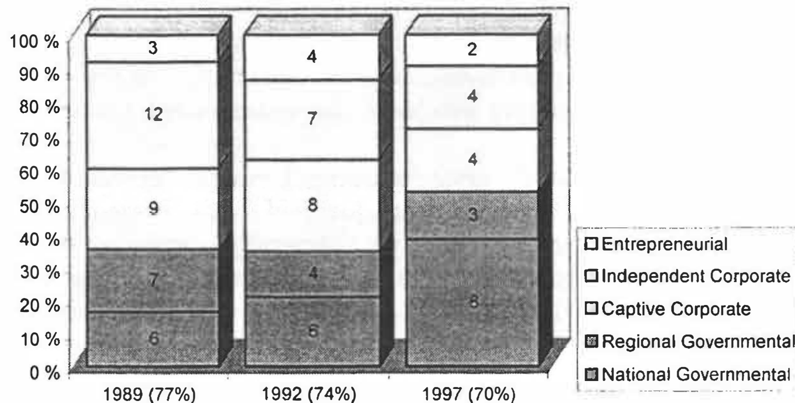

FIGURE 40 Finnish respondent companies by owner type (1989, 1992, 1997)

In 1993, the first entrepreneurial venture capital company *that utilises the LP fund structure* emerged from the MBO of a major player and, in 1997 (after the survey deadline), two additional such MBOs took place.[153] In fact, had the timing of the 1997 survey been late rather than early in the year, a total of six (instead of two) entrepreneurial respondents could have been reached by the survey. The trend is towards management-ownership and utilisation of the LP structure. Although there are exceptions to the rule[154], this holds for both newcomers and existing players. In fact, not many new venture capital companies that utilise a single LTD structure have been launched in Finland since 1997. The following table presents how the respondents foresaw the development of ownership in their companies in 1997. The change of the controlling owner type is envisioned to be significant: Nine of the 19 respondents (or 37%) indicated change therein, and the trend is slightly towards management controlled ownership (see table 11).

TABLE 11 Controlling owner today vs. (as estimated) in the future (1997)

CONTROLLING OWNER (FINLAND 1997)	Corporate (n=8)		Governmental (n=11)	
	Today	Future (e)	Today	Future (e)
Management (of the venture capital company)	0	2 25%	0	2 18%
Private sector entities (corporations/investors)	8 100%	4 50%	0	3 27%
Public sector entities (local/national government)	0	0	11 100%	5 45%
Not indicated	0	2 25%	0	1 9%

In summary, while roughly 10% of the companies in the three Finnish samples were entrepreneurial, as many as 80% were entrepreneurial in the American sample. In the American sample ca. 7% were independent corporate and ca.

153 CapMan Oy in 1993; Sponsor Capital Oy and SFK Finance Oy in 1997.

154 Panostaja Oy (established *entrepreneurial* in 1984) experienced a *corporate* period in the 1990s, due to financial distress, but is (today) back to being entrepreneurial.

14% captive corporate. There were no governmental companies in the American sample (one became excluded for being Canadian), whereas roughly 40% of the respondent firms were governmental in the three Finnish samples.[155]

It is safe to say that the difference between who own venture capital companies in America and Finland is statistically significant. But what about the respondents' respective *perceptions* of themselves (and their companies) as *venture capitalists*? The respondents were asked for such perceptions in 1992, in order to broaden the understanding on how venture capital managers perceive themselves and their companies under the different owner-structures. Table 12 provides the summary findings. As can be noted, the main differences are between the American and the Finnish groups, on one hand, and between the two Finnish groups, on the other (for detailed statistics see appendix 6: Table B).[156]

TABLE 12 Perception of oneself vs. the firm (as a whole) as venture capitalists (1992)

PERCEPTION OF ONESELF AND THE FIRM AS VENTURE CAPITALISTS SURVEY 1992

Entrepreneurial AMERICA	Corporate AMERICA	Corporate FINLAND	Govt FINLAND
Respondent himself:			
1. Entrepreneur	Entrepreneur	**Prof. manager**	**Prof. manager**
2. Financier	Financier	Consultant	Financier
3. Prof. manager	Prof. owner	Entrepreneur	Consultant
4. Prof. owner	Prof. manager	**Financier**	**Entrepreneur**
5. Consultant	Consultant	Prof. owner	Prof. owner
Company as a whole:			
1. Entrepreneurs	Entrepreneurs	**Financiers** ↑	**Prof. managers**
2. Prof. owners ↑	Prof. owners ↑	Prof. managers	Financiers
3. Financiers	Financiers	Prof. owners ↑	Consultants
4. Prof. managers	Prof. managers	Consultants	Prof. owners ↑
5. Consultants	Consultants	**Entrepreneurs**	**Entrepreneurs**

The American respondents strongly perceive themselves as *entrepreneurs* - this is the case also for the corporate respondents (who are hired managers just like all of the Finnish respondents) - whereas the Finns perceive themselves rather as *professional managers*. The difference between Americans and Finns in rating these two qualities is found statistically significant. As to perceptions regarding the firm as a whole: Within each sample, *professional owners* are ranked higher for companies than for the managers themselves (the same applies only to *financiers*, which the Finnish corporates ranked higher as indicated by upwards arrows in table 12). Also here, the differences in perceptions related to rating their companies as *entrepreneurs* were found statistically significant.

155 Of the Finnish respondents, 8.1% were entrepreneurial in 1989, 13.8% in 1992, and 9.5% in 1997. Of them 35.1% were governmental in 1989, 34.5% in 1992, and 52.4% in 1997.

156 The table layout and information content used in appendix 6: Table B (and throughout the study) follow the example of Elango, Fried, Hisrich, and Polonchek (1995). The statistical significance factor (P value) appearing in the tables is derived from the Analysis of Variance (ANOVA) test which is the test vehicle chosen to be used throughout the survey exercise.

5.2.2 Missions: Why are venture capital companies established – what are they vehicles for?

Why are venture capital companies established, in the first place, and what are they vehicles for on the longer term, are the questions addressed in this chapter.

In 1989, venture capital companies in Finland were asked to rate the relative influence of given factors on the company's foundation. Interestingly, both the corporate and the governmental respondents rated 'social conscious' related factors higher than profit-maximising related ones (see table 13). There is indication that the corporate venture capital firms are *slightly* more driven by profiting ambitions than the governmental companies who seem *slightly* more strongly driven by general-economic ones. What remains, however, is the fact that neither group indicates direct financial gains (which expectedly drive the classic framework of venture capitalism) as their 'founding force'. Table 13 provides the comparison of means of the given factors.

TABLE 13 Influence of given factors to starting a venture capital company (1989)

RATING FACTORS BEHIND THE GETTING STARTED DECISION	*(rated 1-7: 1-3 for minor, 4-5 average, 6-7 major)* Corporate						Governmental					FINLAND 1989 *ANOVA*
	Position		Mean	SD	n	Position		Mean	SD	n	*P value*
There was a social call for a venture capital company	major	40%	**5.10**	1.74	20	major	92%	**6.15**	1.34	13	*0.074**
	average	40%				average	0%				
	minor	20%				minor	8%				
Desire to help the Finnish economy and businesses	major	25%	**4.75**	1.07	20	major	58%	**5.75**	1.14	12	*0.018***
	average	65%				average	42%				
	minor	10%				minor	0%				
Personal contribution of certain individual(s)	major	55%	**4.50**	2.19	20	major	8%	**4.08**	1.55	13	*0.550*
	average	10%				average	62%				
	minor	35%				minor	30%				
Other factors (pls. specify)	major	42%	**4.42**	2.61	12	major	36%	**3.36**	2.62	11	*0.345*
	average	17%				average	0%				
	minor	42%				minor	64%				
Apparent business opportunity or market gap	major	16%	**4.21**	1.47	19	major	8%	**3.50**	1.38	12	*0.191*
	average	63%				average	50%				
	minor	21%				minor	42%				
Capitalist pursuit to maximise profit with a new business idea	major	20%	**4.00**	1.65	20	major	0%	**2.42**	1.51	12	*0.011***
	average	35%				average	17%				
	minor	**45%**				**minor**	**83%**				
Fiscal incentives or other such technical arguments	major	11%	**2.21**	1.75	19	major	0%	**1.75**	0.62	12	*0.390*
	average	5%				average	0%				
	minor	84%				minor	100%				

p < 0.100, p** < 0.050, p*** < 0.010, p*** < 0.001*

In table 13, eleven of the thirteen governmental companies specified and rated an *other factor* and as many as four rated the relative influence of such factor 'major'. Twelve of the 21 corporate companies specified and rated an *other*

factor and five rated the influence of such factor 'major'. The other factors rated 'major' by the governmental companies were specified as (i) seeking for new experiment, (ii) tool for regional development policy, (iii) to bypass municipal bureaucracy, and (iv) general municipal restructuring. As these factors all fall into the 'desire to (better and more efficiently) help the Finnish economy' - category, their recoding and inclusion among the given factors would not effectively change the results.

Other factors rated 'major' by the corporate respondents were specified as (i) competition in parent's business, (ii) the corporate venturing idea, (iii) business development on the parent level, (iv) helping the parent in marketing, and (v) strategic reasons (related to parent group). Needless to say, all of these werel *captive* corporate venture capital companies. Recoding and inclusion of these factors among the given ones, would very likely have increased the significance of capitalist pursuit to maximise profit with a new business idea among the corporate respondents. On the other hand, this would be pursuit for indirect rather than direct financial gains pursued by independent players. Nevertheless, these findings only support the results of the ANOVA test.

More than anything, table 13 testifies how Finland was, as a playground for venture capitalists, just one decade ago. The fact that venture capital companies appeared as vehicles of hidden agendas aroused the interest to take a closer look and approach them, particularly, as vehicles of their owners. This, in turn, eventually led to viewing venture capitalism as the business of owners. Table 14 provides an assessment, from 1989, of Finland's potential as a playground for classic venture capital investing. As the table shows, both corporate and governmental players share a strong belief in the progress of circumstances. Later, tables will be provided (from 1992 and 1997) that indicate how Finland has matured as a venture capitalist's playground.

TABLE 14 Evaluating Finland as a playground for classic venture capitalism (1989)

EVALUATING FINLAND'S POTENTIAL TO "ENABLE" CLASSIC VC ACTIVITY	*(Rated 1-5: from minor to major)* Corporate			Governmental			FINLAND 1989 *ANOVA*
	Mean	SD	n	Mean	SD	n	*P value*
In year 1980 (how was it?)	2.30	0.92	20	2.50	1.24	12	*0.606*
in year 1989 (how is it?)	3.10	0.91	20	3.25	1.29	12	*0.703*
In year 2000 (how will it be?)	3.74	0.99	19	3.75	1.22	12	*0.974*

The founding missions, spoken out by venture capital companies in Finland in the 1980s, became under severe pressures to change by the end of the decade. Table 15 illustrates how profitability of operations was truly reported as a marginal concern, at best, for most venture capital companies at foundation. Table 15 also testifies how radical a change had taken place between company founding and the time of the survey (1989). Corporate companies seem to have been dragged towards a harder reality somewhat earlier than governmental companies, but the trend is crystal clear and shared by both.

TABLE 15 Importance of profitability to venture capital company's mission (1989)

IMPORTANCE OF PROFITABILITY TO MISSION	*(rated 1-5: 1-2 for minor, 3 average, 4-5 major)* Corporate Importance		Mean	SD	n	Governmental Importance		Mean	SD	n	FINLAND 1989 *ANOVA P value*
During recent years (1989)	major	47%	**3.47**	1.28	17	major	50%	**3.08**	1.44	12	*0.453*
	average	29%				average	8%				
	minor	24%				minor	42%				
During the following years	major	33%	**3.17**	1.20	18	major	25%	**2.33**	1.23	12	*0.076**
	average	44%				average	17%				
	minor	22%				minor	58%				
During the first years	major	24%	**2.33**	1.43	21	major	8%	**1.77**	1.01	13	*0.223*
	average	5%				average	15%				
	minor	71%				minor	77%				

p < 0.100, p** < 0.050, p*** < 0.010, p*** < 0.001*

In 1989, the change factors of mission and business idea and - hence - strategy logic were rated as presented in table 16. Number one change factor for the corporate companies could be *modernly* labelled as shareholder activism. Interestingly, the number one change factor for the governmental companies were requirements by other stakeholders.

TABLE 16 Reasons for change of business idea (1989)

EVALUATING THE SIGNIFICANCE OF GIVEN ISSUES AS CHANGE FACTORS OF BUSINESS IDEA	*(Rated 1-5: least to most significant)* Corporate Mean	SD	n	rank	Governmental Mean	SD	n	rank	FINLAND 1989 *ANOVA P value*
Growing profit requirements by owners	3.15	1.35	20	1	2.00	1.49	10	4	*0.042***
The limited size of the Finnish market	3.10	1.52	20	2	2.10	1.29	10	3	*0.085**
Insufficient human resources	2.95	1.27	19	3	2.20	1.40	10	3	*0.157*
Requirements by other stakeholders	2.95	1.13	19	3	3.09	0.83	11	1	*0.716*
Lack of resources to acquire certain firms	2.56	1.46	18	5	2.50	1.58	10	2	*0.926*
Fiscal and related aspects	2.11	1.15	19	6	1.45	0.69	11	7	*0.100*
Poor development stage of stock market	1.79	1.08	19	7	1.45	0.69	11	7	*0.366*
"Forced" acquisitions of certain firms	1.68	1.00	19	8	1.50	1.08	10	6	*0.651*

p < 0.100, p** < 0.050, p*** < 0.010, p*** < 0.001*

Engaging also American venture capital companies and, even more interestingly, entrepreneurial companies in the mission analysis brings us to 1992, by which time Finland can be said to have (politically) gained more 'capitalist breathing room' but, on the other hand, (economically) started a dive into a severe, historic recession.[157] By 1997, at which point there is another

[157] In 1989, Finland still had the USSR as a neighbour and faced with certain geopolitical realities (this showed to an extent as voluntary censorship in the media where, e.g., *capitalist* was no popular word). Economically, Finland was a relatively closed and

measurement of the Finnish arena, the country had risen from the recession, and joined the EU. In other words, the Finnish playground now resembled the American one more than ever before, both economically and politically. Table 17 provides information on missions of venture capital companies and their changes in America and Finland.

TABLE 17 Mission of the venture capital company (1992, 1997)

Mission "Money": *"To buy, add value to, and sell interests in prospective companies simply to make a large pile of* money*"*

Mission "Strategy": *"To* venture *into such industries and technologies that contribute to the* strategic interests *of your funders"*

Mission "Jobs": *"To make investments that enhance the economic growth and* job creation *of your country or a given region"*

FOUNDING VERSUS CURRENT MISSION		AMERICA 1992 Entrepr.	AMERICA 1992 Corp.	FINLAND 1992 Corp.	FINLAND 1992 Govt	FINLAND 1997 Corp.	FINLAND 1997 Govt
Mission estimated for the future	*Money*	n.a.	n.a.	n.a.	n.a.	7 (100%)	6 (60%)
	Strategy					0	1 (10%)
	Jobs					0	3 (30%)
Mission at time of survey	*Money*	27 (77%)	5 (56%)	8 (57%)	3 (30%)	7 (100%)	4 (40%)
	Strategy	8 (23%)	4 (44%)	4 (29%)	3 (30%)	0	1 (10%)
	Jobs	0	0	2 (14%)	4 (40%)	0	5 (50%)
Mission at foundation:	*Money*	26 (74%)	4 (44%)	5 (36%)	1 (10%)	3 (43%)	2 (20%)
	Strategy	9 (26%)	5 (56%)	8 (57%)	1 (10%)	1 (14%)	1 (10%)
	Jobs	0	0	1 (7%)	8 (80%)	3 (43%)	7 (70%)

Roughly 75% of the entrepreneurial venture capital firms indicate a relatively unchanged founding mission, which could be labelled as *direct financial*. A majority of both the American and the Finnish corporate venture capital firms indicate other founding mission. Most of their founding missions in 1992 could be labelled as *indirect financial*. The 1997 sample of Finnish corporate companies indicate less such, more *indirect economical* rationale behind their getting-started decision. In any case, a majority in each of the three corporate samples indicates their current mission (at the time of survey) as *direct financial*. This is somewhat less clear in 1992 than 1997, however, when all corporate companies indicate *direct financial* as their current mission. The governmental venture capital companies of both surveys confirm the finding of the 1989 survey that their by-far predominant founding mission can be labelled as *indirect economical*. They also confirm the trend from indirect (softer) towards more direct (harder) missions. In 1997, 60% of the governmental venture capital companies estimate that their mission in the future will be direct financial. At this instance, it is worthwhile pointing at the earlier finding (see table 11), according to which

protected market until quite late in the 1980s. At year-end 1991, the USSR collapsed and in 1995 Finland joined the EU.

only 45% of the governmental respondents foresaw remaining governmental in the future. This is in no conflict with the thesis that owner type matters to strategy logic in venture capitalism.

In order to dig deeper still into the missions of the venture capital companies, the respondents were asked to rate the relative importance of given objectives to their mission (see table 18). The findings of the 1992 survey suggest strong statistical dependence between the owner type and the importance of given objectives to company mission. In fact, the (American) entrepreneurial and the (Finnish) governmental players rank the four objectives completely *vice versa*. Interestingly enough, also the Finnish corporate respondents place the lowest relative importance to providing maximum return to company management. Equally interesting is the notion how differently American and Finnish corporates value the different objectives. Admittedly, since their is less variation between the owner types within the two national samples, these findings highlight more the difference between American and Finnish venture capital companies than between the different owner types.

This is not to suggest, however, that no difference is to be found between owner types nationally; the Finnish corporates place significantly more importance in providing a safe return to funders (which they rank first) than the governmentals (who rank this only third). Also, the corporates are out to achieve 'other than directly financial returns' as 'socially responsible players' far more clearly than the corporates. When it comes to differences between the (American) entrepreneurial and corporate players, they are not noteworthy - which is somewhat surprising, since two thirds of the American corporates are captive players, which would be expected to be after hidden agendas more than entrepreneurial players. It could be that, besides the differences in capitalism between the two countries, the American venture capital arena's more advanced compensation systems - and hence the more soundly aligned interests between funders and management (of even the captive situations) - are reflected and explain the responses.

TABLE 18 Relative importance of given objectives to company mission (1992)

RELATIVE IMPORTANCE OF GIVEN OBJECTIVES:	*(Rated 1-5: 1-2 for none, 3-4 for some, and 5 for great)* Entrepreneurial AMERICA Importance	Mean *(rank)*	SD	n	Corporate AMERICA Importance	Mean *(rank)*	SD	n	Corporate FINLAND Importance	Mean *(rank)*	SD	n	SURVEY 1992 Governmental Importance	Mean *(rank)*	SD	n	*ANOVA P value*
Provide maximum return to VC firm management	great 46%	**4.3**	0.68	35	great 44%	**4.2**	0.97	9	great 20%	**2.8**	1.52	15	great 0%	**1.5**	0.71	10	*0.000****
	some 54%	*(rank 1)*			some 44%	*(rank 1)*			some 33%	*(rank 4)*			some 10%	*(rank 4)*			
	none 0%				none 11%				none 47%				none 90%				
Provide safe return to funders	great 43%	**3.8**	1.35	35	great 11%	**3.1**	1.27	9	great 40%	**3.9**	1.10	15	great 10%	**2.9**	1.10	10	*0.115*
	some 43%	*(rank 2)*			some 56%	*(rank 2)*			some 47%	*(rank 1)*			some 60%	*(rank 3)*			
	none 14%				none 33%				none 13%				none 30%				
Achieve other than directly financial returns	great 9%	**2.4**	1.26	34	great 11%	**2.1**	1.54	9	great 21%	**2.9**	1.56	14	great 40%	**4.2**	0.79	10	*0.002****
	some 38%	*(rank 3)*			some 22%	*(rank 3)*			some 36%	*(rank 3)*			some 60%	*(rank 2)*			
	none 53%				none 67%				none 43%				none 0%				
Be socially responsible in investment strategy	great 11%	**2.4**	1.29	35	great 0%	**2.0**	1.12	9	great 7%	**3.0**	1.00	15	great 50%	**4.3**	0.82	10	*0.000****
	some 34%	*(rank 3)*			some 33%	*(rank 4)*			some 53%	*(rank 2)*			some 50%	*(rank 1)*			
	none 54%				none 67%				none 40%				none 0%				

p < 0.100, p** < 0.050, p*** < 0.010, p*** < 0.001*

At the core of venture capitalism

The possibility that strategy has to do with ownership, in venture capital, does not mean that venture capital managers of differently-owned firms could not agree on the characteristics of 'true venture capitalism'. In fact, table 19 illustrates just how much the differently motivated venture capital players agree on what is *true venture capitalism*. The corporate and the governmental respondents do de-emphasise hidden agendas somewhat less than the entrepreneurial ones, but to no significant extent. Of the entrepreneurial players 54% place major importance on the absence of hidden agendas, whereas only 38% of both American and Finnish corporate players and 40% of the governmental place major value on the absence of hidden agendas (for additional insight into the table's setting, see appendix 6: Table C). In the light of everything above, even greater disagreement could be expected.

TABLE 19 Characteristics of true venture capital evaluated (1992)

RELATIVE IMPORTANCE OF GIVEN ASPECTS ON WHAT IS TRUE VC	*(rated 1-5; from least to most important)* AMERICA Entrepreneurial			Corporate			FINLAND Corporate			Governmental			SURVEY 1992 *ANOVA*
	Mean	SD	n	Mean	SD	n	Mean	SD	n	Mean	SD	n	*P value*
Buying and selling equity interests for profit	**4.1**	0.88	35	**4.3**	0.87	9	**4.4**	0.51	14	**4.1**	1.10	10	*0.689*
Management's control of provided funds	**3.8**	1.16	35	**4.0**	0.71	9	**3.1**	1.19	13	**3.5**	1.18	10	*0.177*
Purpose to make money: No hidden agenda	**3.7**	1.35	35	**3.4**	1.41	8	**3.0**	1.47	13	**2.9**	1.37	10	*0.319*
Classic investee venture characteristics	**3.5**	1.17	35	**3.4**	1.06	8	**2.5**	1.05	13	**3.2**	1.40	10	*0.081**
High risk associated with the investment	**2.9**	1.26	35	**3.0**	1.31	8	**1.9**	0.99	13	**2.0**	1.05	10	*0.013***

p < 0.100, p** < 0.050, p*** < 0.010, p*** < 0.001*

Similarly, in 1997, when Finnish respondents were asked to rate the characteristics of the ideal venture capitalist, a relatively unanimous understanding was reported - topped with similar differences of flavour than above (see table 20). To both the corporate and the governmental players the ideal venture capitalist is an entrepreneur, a natural person rather than a faceless institution. Both placed the lowest relative value on his role as an economic developer. However, whereas the corporate players placed independence (of funders) as the ideal venture capitalists second most important characteristic (ranked third by governmentals), the governmentals placed the risk taking propensity second (ranked only fourth by the corporates). Moreover, whereas none of the corporates placed profit seeking as the least important characteristic of the ideal venture capitalist, as many as 40% of the governmentals did that.

TABLE 20 Characteristics of the ideal venture capitalist (1997)

CONSTRUCTING THE "IDEAL" VENTURE CAPITALIST	*(rated 1-5: 1 least, 2-4 average, and 5 most imp.)* Corporate Position		Mean *(rank)*	SD	n	Governmental Position		Mean *(rank)*	SD	n	FINLAND 1997 *ANOVA P value*
Entrepreneur (is human,	most	43%	**4.00**	1.00	7	most	55%	**3.82**	1.54	11	*0.786*
'tangible' partner,	average	57%	*(rank 1)*			average	36%	*(rank 1)*			
not faceless institution)	least	0%				least	9%				
Independent (develops	most	33%	**3.83**	1.47	6	most	0%	**3.10**	1.10	10	*0.274*
investees', not	average	50%	*(rank 2)*			average	90%	*(rank 3)*			
funders' businesses)	least	17%				least	10%				
Profit seeker (maximises	most	17%	**3.50**	1.05	6	most	30%	**2.60**	1.78	10	*0.282*
investment profit,	average	83%	*(rank 3)*			average	30%	*(rank 4)*			
sells to highest bidder)	least	0%				**least**	**40%**				
Risk taker (minority stakes	most	17%	**2.33**	1.51	6	most	18%	**3.36**	1.12	11	*0.128*
in entrepreneurial	average	50%	*(rank 4)*			average	82%	*(rank 2)*			
high tech start-ups)	least	33%				least	0%				
Developer (generates new	most	0%	**1.50**	0.55	6	most	9%	**2.45**	1.37	11	*0.126*
employment and	average	50%	*(rank 5)*			average	55%	*(rank 5)*			
growth of economy)	least	50%				least	36%				

In conclusion, deriving from tables 19 and 20, *owner activism* (buying and selling of equity interests for direct profit seeking purposes as independent players, free from hidden agendas) - rather than *classic ideals* (high risk, minority stakes in high-tech start-ups), *per se* - is found at the core of venture capitalism.

5.2.3 Governance: How are venture capital companies structured, owned, and organised?

In this study, governance relates to how the shareholders of a company monitor the company's management and its fulfilment of the company's mission and to which extent they participate in the strategy making of the company.

As has been established before, the respondent companies to each of the surveys have been classified as either entrepreneurial, corporate or governmental depending upon the controlling owner group of the company. By definition, shareholders of the entrepreneurial companies themselves manage the company's day-to-day operations and business. No outside shareholders have significant roles in the company governance. Entrepreneurial companies could in a way be referred to as management-governed firms but, as this label will become reserved for an entirely different situation, they will be referred to as *owner-managed.*

The starting point is the legal form chosen for the venture capital fund vehicles. When a venture capital company structures itself as an evergreen investment corporation (LTD), it is set to offer investors (funders) shares of equity in the company itself. To the extent to which the shares offered to

funders bear voting rights, the ownership of control - i.e., the venture capitalist's position - is a part of the vehicle being offered to the funders. In other words, the ownership of control is not separated from the ownership of capital in the LTD structure. In case a venture capital company only has one class of common shares, every new issue of stock (every new fund raising exercise) dilutes the venture capitalist's ownership share in the venture capital company. The venture capitalist's only way of preventing loss of control (and eventual change of venture capitalist) is, at a given point, to start subscribing for the offered shares himself. Nevertheless, in an LTD type venture capital company, the board of directors, appointed by a general meeting of shareholders, is by law the top dog. What is interesting is who hold seats in such boards and why, and how they govern. At one extreme, the board members are *truly* selected by the shareholders and the president *truly* hired by the board, whereas, at the other extreme, the board members are truly selected by a previously hired president who might even serve as the chairman of the board. In this study, the latter cases (which do exist in the real world of venture capitalism) are referred to as *management-governed* companies.[158]

When a venture capital company offers to funders limited partners' interests in limited-life LP fund vehicles, the ownership of control and capital becomes, by definition, separated. In an analogy to the LTD structured venture capital company, the limited partners' interests can be said to resemble preferred *non-voting* stock and the general partners' interests the common stock of such firm. In terms of governance complexities, which technically relate to principal-agent relationships, the LP structure sounds like plain vanilla: The general partner is the venture capitalist and the limited partners are the financiers of his business with limited role and rights as to decision making. But, then again, there are variations as to who actually makes the decisions of an LP fund vehicle. These variations include the situation where the limited partners compose an investor council which (effectively) holds powers comparable to those of the board of directors in the LTD structure. In such cases, the investor council should be appreciated as the top dog.

As becomes evident from the following table, the majority of companies in seven of the eight samples operate under an LTD based structure. The one sample that strikes out with a majority of companies operating under an LP based structure is the entrepreneurial sample. As many as 91% of the entrepreneurial respondents have chosen to separate the ownership of control from the ownership of capital. It would be tempting to claim that the choice of structural setting has helped these companies remain entrepreneurial. For the LTD based companies it is difficult - if not impossible - to conceptually separate between the owners of the venture capital company and the funders thereof, since both groups are investors in the equity of the venture capital

[158] Many companies are sort of 'half-way'; they may have strong hired presidents serving as the chairmen but also genuinely shareholder-selected members in their boards who (essentially) carry the responsibility of monitoring.

company. The following table presents the structural choices of the respondent companies in each of the survey samples.

TABLE 21 Structure of the venture capital fund vehicle (1989, 1992, 1997)

VEHICLE	FINLAND 1989		AMERICA 1992		FINLAND 1992		FINLAND 1997	
STRUCTURE	Corp	Govt.	Entrep.	Corp.	Corp.	Govt.	Corp.	Govt.
Info released:	n 21	n 13	n 35	n 9	n 15	n 10	n 8	n 11
LP based	0%	0%	91%	44%	27%	30%	25%	27%
LTD based	100%	100%	9%	56%	73%	70%	75%	73%
Total	100%	100%	100%	100%	100%	100%	100%	100%

Although none of the included respondent firms to the 1989 survey were entrepreneurial and all were LTD based (under which structure it is difficult to maintain an entrepreneurial status), a majority of both the corporate and the governmental respondents agreed that the management of venture capital companies should include partners (shareholder-managers) of the firm. Interestingly, the governmental firms were slightly more in agreement here than their corporate counterparts (62% vs. 53%) - but to no significant extent.[159] Much more clearly (over 90% of both), both groups agreed that it is important to create an entrepreneurial culture inside the venture capital firm, and (ca. 75% of both) that the role of the board of directors is greater in a venture capital company than in more 'conventional' businesses (see appendix 6: Table D). This is no wonder, since (as results presented below will show) this has been a business, at least in Finland, in which the board (composed by industry outsiders) actually makes the *raw material purchasing* decisions.

The monitoring of and the participation in company management by industry-outsiders have, indeed, historically remained *deep* and *wide* in venture capitalism in Finland. It would be surprising, if in any other business non-owning shareholder-representatives from outside the industry had engaged deeper and wider in corporate governance. As late as 1997, the majority of respondents (50% of corporates and 55% of governmentals) agreed that even if the management included partners, purchasing decision should belong to the funders (see appendix 6: Table E). Interestingly, however, even more strongly both groups (63% of corporates and 70% of governmentals) agreed that venture capitalism should be based on entrepreneurship where decision power is vested with the management and the funders' role be limited to monitoring only (only 25% of corporates and 20% of governmentals disagreed). In the controversy of these positions, one could see reflections of *realism* ('this is how it has always been and, realistically, will be') and *idealism* ('this is how it is not but, idealistically, should be').

[159] Of the governmentals only 15% disagreed, while 26% disagreed of the corporates.

Distribution of *funder* influence[160]

In 1989, venture capital companies were asked to rate their owners' influence on selected issues that shape the company's being (see appendix 6: Table F). Here, a statistically significant difference was discovered in the owners' appetite for dividends. Whereas 50% of the corporates indicated that their owners' influence shows strongly as *requirements for more dividends*, this was the case with only 8% of the governmental respondents. This further confirms that governmental venture capitalists appear to be less interested in direct financial returns than corporate ones. Another interesting difference (though not statistically significant) was the owners' influence on the various *levels* of company management - the institutional, strategic, business, and operative (a conceptualisation of Tainio, Räsänen, and Santalainen 1988). While owners' influence was perceived the greatest on the *strategic* level within both groups, the governmental respondents perceived (relatively) more owner influence on the *operative* level than their corporate colleagues. While the corporates found their owners the least active on the operative level, the governmentals found theirs the second most active there. Conversely, the corporates ranked their owners' influence on the institutional level the second most active, while the governmentals ranked this the least active level.

In 1992 vs. 1997 - judging from table 22 below - the Finnish corporate respondents report increase in funder influence on entering decisions and decrease on exiting decisions. Governmentals report no noteworthy increase in any category, but a decrease in value-adding and exiting related decisions. After mission and strategy, for which both groups report the greatest funder influence in both 1992 and 1997, corporates find their funders relatively more active at the entering stage than governmentals do. On the other hand, governmentals report more funder concern for fund-raising issues.

When comparing the American corporates with their Finnish peers, the Finns in 1992 reported more funder influence in each of the given categories. The difference was greatest with regard to exiting (mean 1.8 for the Americans vs. 3.2 for the Finns), general strategy (2.6 vs. 3.9), and entering (1.8 vs. 3.1). The two were closest with regard to funder influence on investment criteria. Interestingly, the same can be said when comparing the two American samples. There is a significant difference in how they perceive influence on exiting related decisions (mean 1.8 for the corporates, 3.0 for the entrepreneurials). Moreover, whereas the corporates rate funder influence on value-adding decisions *lower* than any of the four groups, the entrepreneurials rate this *higher* than any of them (means 1.9 vs. 2.7). It is safe to conclude that funder influence is, on average, perceived greater in Finland than America, and it seems to be in the greatest balance among the entrepreneurial companies.

[160] Going from the 1989 to the 1992 survey a clearer conceptual difference was made (in the language of the survey questionnaires) between the *owners* of a venture capital company and *funders*. Funders were still labelled *investors* in the original questionnaires, however. Below, and in the copies of the questionnaires (appendices 3-5), the word *funder* is being used.

It is most interesting to find 63% of the American corporate respondents indicating that there is *no funder influence* on their entering decision-making (see appendix 6: Table H). On the other hand, the question measured *funder*, not *owner* influence on the given issues. As two thirds of the American corporates were originally classified as captive corporate venture capital companies, the fact that they rated *funder influence* on their decision-making significantly weaker than their peers in many of the table 22 issue categories, is perhaps a sign of the greater influence of their *corporate parents* (or owners) therein.

Who makes the investment decision

When asked to determine who makes the venture capital investment decision, in 1989 in Finland, both groups quite unanimously emphasised the role of the board of directors, along with the president, as the key authority - as many as 62% of the corporates and 58% of the governmentals gave the board the maximum rating (see table 23 below; also, see appendix 6: Table H for more descriptive statistics). President was so rated in 53% of the corporate responses and in 45% of the governmental ones.[161] The role of a given manager is emphasised by the governmental respondents, but this largely due to the fact that only three of the thirteen governmentals rate it to begin with.

By 1992, the role of senior management as a decision making authority had strengthened among corporates in Finland (see table 23). As for the governmentals, the trend had been the opposite. And yet, even for the corporates, senior management still ranked only third as a decision-making authority, following the board and the president; only the margin had narrowed. In 1992, as many as 79% of the corporates and 62% of the governmentals gave the board the top rating (see appendix 6: Table G). For *president* the figures were 46% and 38%, respectively. In 1992, as many as 50% of the corporates gave senior management the top rating (up from 39% in 1989), while only 14% of the governmentals did the same (down from 25% in 1989).

A significant difference when comparing Americans and Finns in 1992 is in the roles of the board of directors and the senior management as decision makers. In the *board-president-senior management* 'triangle', for both entrepreneurials and corporates, senior management was by far the most and the board by far the least important decision maker. It could be argued that the Finnish corporate respondents had, over 1989-1992, developed towards their American colleagues in that the 'weight' of the senior management had risen. Similarly, the governmentals could be argued to have distanced themselves from the American tradition. Regardless, the strong role of the board of directors as a decision maker had continued in both Finnish respondent groups. Then again, there was no remarkable difference in how the other decision makers were ranked between the four groups.

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[161] It is noteworthy that, in 1989, fifteen (or 71%) of the corporate responses are filled in by the venture capital company president, one (or 5%) is filled-in by a director of the board, and five (24%) by other senior manager. Of the governmental responses twelve (or 92%) are filled-in by the president and one (or 8%) by a director.

TABLE 22 Influence of funders on the venture capital company's decision making (1992, 1997)

INFLUENCE OF FUNDERS ON DECISION MAKING REGARDING:	*(Rated 1-5: from no to major influence)* AMERICA 1992 Entrepreneurial Mean	SD	n	Corporate Mean	SD	n	FINLAND 1992 Corporate Mean	SD	n	Governmental Mean	SD	n	*ANOVA P value*	FINLAND 1997 Corporate Mean	SD	n	Governmental. Mean	SD	n	*ANOVA P value*
Mission (+strategy in 97)	**3.1**	1.41	35	**3.1**	1.46	8	**3.9**	0.86	13	**4.1**	0.99	10	*0.072**	**3.9**	1.21	7	**4.1**	1.14	11	*0.684*
Strategy (Fund-raising in 97)	**3.0**	1.34	35	**2.6**	1.19	8	**3.9**	0.86	13	**4.3**	0.82	10	*0.003****	**2.4**	1.81	7	**3.0**	1.95	11	*0.543*
Exiting decisions	**3.0**	1.19	35	**1.8**	0.71	8	**3.2**	1.17	13	**2.5**	0.85	10	*0.015***	**2.0**	1.15	7	**1.6**	0.93	11	*0.372*
Value adding decisions	**2.7**	1.43	35	**1.9**	0.83	8	**2.4**	1.12	13	**2.4**	0.97	10	*0.372*	**1.6**	0.98	7	**1.8**	1.08	11	*0.631*
Investment criteria	**2.6**	1.19	35	**2.3**	1.16	8	**2.4**	0.85	14	**3.0**	1.05	10	*0.495*	**2.4**	1.27	7	**2.9**	1.14	11	*0.416*
Entering decisions	**2.3**	1.43	35	**1.8**	1.16	8	**3.1**	1.17	14	**3.1**	1.36	9	*0.056**	**3.7**	1.38	7	**2.8**	1.08	11	*0.142*

p < 0.100, p** < 0.050, p*** < 0.010, p*** < 0.001*

TABLE 23 Who makes the venture capital investment decision (1989, 1992)?

WHO MAKES THE VENTURE CAPITAL INVESTMENT DECISION	*(rated 1-5: 1 from least to most influence on decision making)* FINLAND 1989 Corporate Mean	SD	n	Governmental Mean	SD	n	*ANOVA P value*	AMERICA 1992 Entrepreneurial Mean	SD	n	Corporate Mean	SD	n	FINLAND 1992 Corporate Mean	SD	n	Governmental. Mean	SD	n	*ANOVA P value*
Funders (Owners in 1989)	**2.3**	1.28	15	**2.0**	1.41	8	*0.651*	**1.8**	1.25	30	**1.2**	0.41	6	**2.3**	0.95	7	**1.4**	0.79	7	*0.282*
Board of directors	**4.5**	0.68	21	**4.4**	0.79	12	*0.685*	**1.7**	1.07	25	**2.3**	1.60	7	**4.6**	0.85	14	**4.3**	1.16	8	*0.000****
Senior management	**3.8**	1.31	18	**3.6**	1.30	8	*0.786*	**4.7**	0.96	35	**4.6**	0.74	8	**4.3**	0.87	12	**2.9**	1.57	7	*0.001****
Junior Management	n.a.			n.a.				**2.3**	1.32	28	**3.7**	1.21	6	**2.8**	1.17	6	**2.1**	1.55	8	*0.103*
President	**4.3**	0.99	19	**4.2**	0.98	11	*0.830*	**3.6**	1.81	26	**3.8**	1.79	5	**4.4**	0.65	13	**3.4**	1.77	8	*0.454*
Other manager or party	**2.6**	1.39	13	**4.7**	0.58	3	*0.028***	**1.3**	0.69	23	**2.0**	2.00	4	**2.3**	2.31	3	**1.8**	1.33	6	*0.297*

p < 0.100, p** < 0.050, p*** < 0.010, p*** < 0.001*

In 1997 (Finland), the question setting was greatly simplified. As to who make the decisions, the respondents were offered a choice between representatives of *funders*, *management*, and *outsiders*. None of the respondents marked outsiders as decision makers in any of the given situations. Instead, as can be seen from table 24 below, a vast majority of both the corporate and the governmental respondents indicated representatives of funders as the key decision makers with regard to entering and exiting decisions. The managers of governmental companies seem to have a more deviating 'authority profile' than their corporate colleagues in that they quite strongly indicate controlling investment criteria, coupled with a somewhat weaker position regarding entering decisions and compromised, again, by a somewhat stronger position regarding exiting decisions than is vested with their corporate peers.

TABLE 24: Who makes the venture capital investment decision (1997)?

WHO MAKES THE DECISIONS	Corporate Who decides?	n	%	Governmental Who decides?	n	% FINLAND 1997
Investment criteria	funders	4	67%	funders	3	27%
	management	2	33%	management	8	73%
Buying interests	funders	5	71%	funders	9	82%
	management	2	29%	management	2	18%
Selling interests	funders	5	71%	funders	7	64%
	management	2	29%	management	4	36%

Composition of the board of directors

As established above, the role of the board of directors was a significant differentiating factor in decision-making between American and Finnish venture capital companies in 1992. In Finland, the board was perceived by far more important than in America. In fact, it was ranked number one decision-making authority by both the corporate and the governmental Finnish samples. Still in 1997, both Finnish groups indicated that funder-representatives control their decision making.

The board compositions of the four 1992 respondent groups reveal many interesting differences between them (see table 25). The entrepreneurial companies have the smallest boards (4.6 directors on average), followed by the governmentals (5.4 directors), American corporates (5.6) and Finnish corporates (6.0 directors). Whereas 35% of the entrepreneurials have extremely compact boards (no more than three directors), only 10% of the governmentals and 13% of the American corporates have such lean boards. None of the Finnish corporates fall into this category. Though not statistically significant, the difference in board size – the fact that entrepreneurial companies have the smallest boards – is in accordance with the general image of owner-managed firms being operated under less bureaucratic, more dynamic circumstances.

Over one half of the entrepreneurial respondents report that members of the venture capital company management hold over 50% of seats in the board of directors; the average percentage of seats held being as high as 67% (due to the fact that as many as 47% of them report management holding all seats in the board). Whereas management holds some seats in all of the American respondent firms, they hold no seats in 64% of the Finnish corporate and 33% of governmental companies.

Even more strongly than the management seems to control the boards of directors in entrepreneurial companies, the representatives of funders seem to control the boards in corporate firms in Finland. In 71% of the Finnish corporate companies they hold a majority of board seats (average percentage for seats held being 60%). What is particularly interesting is the fact that as many as 43% of the American corporates and 44% of the governmentals report that no representatives of their funders are among the board members. For these two groups, outsiders comprise (relatively) the biggest segment of board members. Outsiders reportedly hold majority in 43% of the American corporates and 44% of the governmental companies (average percentages for seats held being 38.4 and 46.9, respectively). Interestingly, as if to underline the significance of differences discovered in board compositions, 73% of the entrepreneurial respondents report no outsiders in their boards, while only 29% of the American and 36% of the Finnish corporates and only 22% of the governmentals report the same.

With regard to the confidential nature of many new business ventures seeking for venture capital financing, and the personal interests of many of the entrepreneurs behind such ventures to protect their personal and business information, it is tempting to claim that the leaner the decision making body of a venture capital company and the more compact the group of individuals to whom an entrepreneur's story is disclosed, the better the structure is competitively – other competitive issues controlled – on the long run.

Board decision making

Some differences can be noted between entrepreneurials and American corporates, of which the latter group seems to be more into simple-majority voting. For the Finnish groups, the governmentals seem to be more into voting than the corporates. It is tempting to conclude that the entrepreneurial venture capital companies, more often than any other group, look for team decision and commitment (see appendix 6: Table I)

TABLE 25 Composition of venture capital company board of directors (1992)

COMPOSITION OF VC COMPANY BOARD OF DIRECTORS	*(Rated 1-5: Industry 1-2 for growth, 3 shakeout, 4-5* mature*; Company 1-2 for early, 3 growth, 4-5* mature*)*																SURVEY 1992
	Entrepreneurial AMERICA				Corporate AMERICA				Corporate FINLAND				Governmental FINLAND				*ANOVA*
	Make-up (%)	Mean	SD	n	Make-up (%)	Mean	SD	n	Make-up (%)	Mean	SD	n	Make-up (%)	Mean	SD	n	*P value*
Total members in the board (#)	7-9 26%	4.58	2.22	31	7-9 38%	5.62	1.69	8	7-9 33%	6.00	1.36	15	7-9 20%	5.40	1.43	10	*0.097**
	4-6 39%				4-6 50%				4-6 67%				4-6 70%				
	1-3 35%				1-3 13%				1-3 0%				1-3 10%				
VC firm managers in the board (%)	majority 53%	**66.9**	33.3	30	majority 14%	28.6	18.4	7	majority 7%	13.5	27.3	14	majority 22%	26.3	33.3	9	*0.000****
	minority 47%				minority 86%				minority 29%				minority 44%				
	none 0%				none 0%				none 64%				none 33%				
Rep's of funders in the board (%)	majority 23%	25.1	28.1	30	majority 29%	33.0	34.8	7	majority 71%	**59.5**	38.3	14	majority 11%	26.8	32.7	9	*0.014***
	minority 27%				minority 29%				minority 7%				minority 44%				
	none 50%				none 43%				none 21%				none 44%				
Outsiders in the board (%)	majority 0%	8.1	14.7	30	majority 43%	**38.4**	35.6	7	majority 21%	27.0	32.6	14	majority 44%	**46.9**	31.0	9	*0.000****
	minority 27%				minority 29%				minority 43%				minority 33%				
	none 73%				none 29%				none 36%				none 22%				

p < 0.100, p** < 0.050, p*** < 0.010, p*** < 0.001*

5.3 Exploring the strategy world of differently-owned venture capital companies by following the stages of the venture capital process

5.3.1 Entering

Entering is, for all due reasons, the most focused phase within the venture capital process. Going back to the words of Brophy (1986), entering is the stage in which venture capitalists perform their act as the overseers of the market exchange system by physically 'calling the shots'.

Very often, at least in Finland, venture capital companies have been accused of risk-averseness - that they shy away from early-stage, new-technology driven ventures. All as if venture capitalists (for some social rationale) could be duly expected to follow certain (classic) investment preferences even if such did not make the best sense economically. For one thing, the industry and the development stage preferences must follow and vary according to the characteristics and development stage of the *playground.* In this sense, it could have been difficult in 1989 to find a western democracy whose venture capitalism was up against bigger physical and mental leap, in order to catch up with America, than Finland. Interestingly, it could be equally difficult to find one with less (of such leap) left *today*. In *this* sense, following the developments in venture capitalism over the past decade in Finland should be interesting to observers from other countries also.

In this study, the difference between investment preferences and investment criteria is in that the preferences deal with industry (and sector of economy) and venture development stage, whereas the criteria with the differentiating factors between ventures *within* given preferences. To an extent, investment criteria can be thought of as comparable across differing investment preferences, but not the other way around. But there are exceptions to the general rule. For example, venture capital companies preferring newer industries and early-stage ventures therein may put a greater emphasis on *product* as an investment criteria, because they have such preferences, rather than because they are, e.g., government-owned.

Notwithstanding the above, this study explores differences in investment criteria between different players *not controlling* the preferences by any other means than by including *industry* among the investment criteria asked to be rated. For the present analysis, fifteen different investment criteria, rated in 1989 and 1992, have been included (see table 26).

In 1989, the Finnish corporate respondents ranked industry their top criteria, whereas the governmentals ranked it only as the sixth most important. The corporates also emphasised the size of the offered ownership stake more than their governmental peers (6th vs. 11th). On the other hand, the governmentals emphasised the investee's geographical location far more than the corporates did (7th vs. 12th). Significant or more or less 'close-to-significant',

differences were also discovered with regard to the expected final ROI and fiscal planning aspects related to the deal (see appendix 6: Table J).

In 1992, the difference between how the two Finnish groups emphasise the expected final ROI had only become more evident: For the corporates it had remained number two criteria, whereas for the governmentals it had fallen from fourth to a shared eighth position. Although still emphasising the size of ownership stake offered less than corporates (as in 1989), control over investee management had risen from eighth to fourth position for the governmentals in 1992, whereas it had fallen from sixth in 1989 to eleventh in 1992 for the corporates. A significant increase in value was placed by the governmental respondents on other deal participants (up from 13th in 1989 to a shared 5th in 1992). It is fair to conclude this as a signal of some bad experiences related to investments made during the 1989-1992 period, by the end of which time Finland was already deep into its historic recession. The governmental players had perhaps learned lessons related to the due diligence process.

Comparing the two American samples, the entrepreneurial respondents place more emphasis on the investee's entrepreneurial culture than their corporate colleagues do (ranked 5th and 10th, respectively). Also, the entrepreneurials place more importance on the geographical location of the investee than the corporates (ranked 7th vs. 13th). The corporates, in turn, place more importance on other deal participants than the entrepreneurials (7th vs. 11th). Other than the above, the two American groups do not greatly vary in their investment criteria. The bottom line remains, however: The entrepreneurial venture capital companies place more (relative) value on *entrepreneurial culture* than any other group (Finnish corporates rank entrepreneurial culture 11th and 9th, and governmentals 12th and 7th, in 1989 and 1992 respectively). The fact that even the governmental venture capital companies in 1992 rank entrepreneurial culture higher than their corporate peers, both Finnish and American, may tell us more of the cultural values and motives of the corporate players than of those of governmentals or entrepreneurials.

Comparing the main differences between American and Finnish respondents, three criteria come up. The Americans, more than Finns, place value on the financial skills of their investee management. The Finns, in turn, place more value on the debt-to-equity ratio and control over management. Even if these come as no surprises, the message is clear: Venture capital companies in Finland belittle the importance of investee financial management capabilities, perhaps prepared for a particular value-adding role within this function or by simply selecting financially healthier companies, as they can be seen doing. The fact that the corporate Finns give a significantly higher absolute rating on fiscal planning aspects than any other group in both 1989 and 1992, can be seen as a signal of the underdeveloped status of exit mechanisms in Finland vs. America at the time.

TABLE 26 Venture capital company's investment criteria (1989, 1992)

	FINLAND 1989		AMERICA 1992		FINLAND 1992	
	Corporate	Governmental	Entrepreneurial	Corporate	Corporate	Governmental
1.	**Industry**	General ability of mgmt	General ability of mgmt	General ability of mgmt	General ability of mgmt	General ability of mgmt
2.	Expected final ROI	Market	Expected final ROI	Expected final ROI	**Expected final ROI**	Market
3.	*Product*	Product	Market	Market	Product	Marketing skills
4.	*Market*	Expected final ROI	Marketing skills	Marketing skills	Market	**Control over mgmt**
5.	General ability of mgmt	Debt-to-equity ratio	**Entrepreneurial culture**	Product	Industry	***Other deal participants***
6.	**Size of ownership stake**	***Industry***	Product	Financial skills	*Marketing skills*	*Debt-to-equity ratio*
7.	Control over mgmt	***Geographical location***	**Geographical location**	**Other deal participants**	*Debt-to-equity ratio*	Entrepreneurial culture
8.	*Debt-to-equity ratio*	Control over mgmt	Industry	Industry	*Size of ownership stake*	*Product*
9.	*Marketing skills*	*Marketing skills*	Financial skills	Debt-to-equity ratio	Entrepreneurial culture	***Expected final ROI***
10.	*Business risk*	*Business risk*	Size of ownership stake	**Entrepreneurial culture**	Business risk	Industry
11.	Entrepreneurial culture	**Size of ownership stake**	**Other deal participants**	Size of ownership stake	**Control over mgmt**	Geographical location
12.	**Geographical location**	Entrepreneurial culture	Debt-to-equity ratio	Control over mgmt	Geographical location	Size of ownership stake
13.	Financial skills	Other deal participants	Control over mgmt	**Geographical location**	**Other deal participants**	Financial skills
14.	Other deal participants	Financial skills	Business risk	Business risk	Financial skills	Business risk
15.	Fiscal aspects	Fiscal aspects	Fiscal aspects	Fiscal aspects	Fiscal aspects	Fiscal aspects

Ranking based on mean analysis (see appendix 6: Table J). The investment criteria that received an equal mean appear in italics in each column. The top-three investment criteria, the ranking of which appears to vary the greatest in each of the three "comparison-pairs", appear in bold. It is to be remembered that the 1989 and the 1992 surveys used somewhat differing rating procedure.

The aspect referred to above, that governmental venture capital firms may have learned lessons on the due diligence process in 1989-1992, becomes further enlightened in an analysis of historical deal-flow closing rates (see appendix 6: Table K). Such an analysis was performed on each of the respondent groups in the 1989 and the 1992 surveys. In the calculation, the historical (accumulated) number of closed deals for each firm was divided by the historical number of business plans offered to the firm (historical total deal flow). In the analysis, the difference between Finnish and American respondents is quite significant. For the Americans in 1992, the average deal-flow closing rates are 1.6% for the entrepreneurials and 2.9% for the corporates, whereas the figures for the Finns are 9.8% for the corporates (down from 10.1% in 1989) and 23.0% for the governmentals (up from 12.4% in 1989).

On average, by 1992, the entrepreneurial players had (in America) invested in one of every 62.5 deals offered, whereas their governmental colleagues in Finland, in one of every 4.3 deals offered. This is a vast difference and necessarily signals of differences, not just in investment diligence, but also in the operating environment. In Finland, the general enterprising mentality (the level of which directly affects the size of deal flow, per se) has allegedly been poorer than in America. The possibility that the management of the entrepreneurial venture capital companies may have worked harder on their deal flow in America than their governmental colleagues have worked on theirs in Finland, cannot be overruled either. The latter explanation is also tempting owing to differences in management incentives, and missions in general, between the two extreme types of players.

The extremely high closing rate for the governmental respondents in 1992 is largely due to the fact that two of the seven companies disclosing this information reported a very high percentage. Five of the seven reported figures for a closing rate between 2-9.99%. Nevertheless, whereas none of the American respondents reported figures for a closing rate at or above ten percent, 53% of the Finnish corporates and 45% of the governmentals did so in 1989, and 23% of the corporates and 29% of the governmentals did so in 1992.

When analysing the sources of leads for closed deals in 1992, the difference between the American and the Finnish respondents is striking. In fact, both Finnish groups rank the proposed sources identically: Approaches by entrepreneurs are ranked number one, approaches by investee managers number two, and own active search for deals number three. Between the two American groups, there are some differences in ranking. Both, however, rank own active search for deals number one. This (even if not statistically significant when comparing absolute means) marks an interesting difference between the two venture capital cultures - for the time being. (See appendix 6: Table L.)

When studying the absolute ratings for the sources of leads, the facts that 75% of the governmentals give the top rating to approaches by entrepreneurs and 63% to approaches by managers support their image as the most passive players of the field. Descriptively, as many as 40% of the entrepreneurial respondents give the top rating to their own active search for deals. These are the highest concentrations of top ratings for any player and for any source.

Approached from yet another angle in 1992 and 1997 (by asking the respondents to rate the importance of the various stakeholder groups when entering vs. exiting) another interesting aspect is discovered. The fact that in 1992 both Finnish groups ranked *commercial banks* the most important reference groups for entering, and that both American groups ranked them the least important, speaks for itself (see appendix 6: Table M). Finland in the early 1990s was still a few-bank-dominated market, where no independent investment banking groups existed. In 1997, banks and insurance companies were still ranked number one by both Finnish groups. The corporates, however, now ranked their own funders a shared first. (See appendix 6: Table O.)

When looking at the development of the geographical operating area of venture capital firms in Finland, a trend towards increasing internationalisation is visible in the responses to the 1997 survey (see table 27). Five of the seven corporate companies that disclosed this information reported having operated only in Finland during the first years of operation and two reported operations in the FSU markets since their launch of business. In 1997, one reports expansion in the FSU, and one in the EU markets outside Finland - only three of the seven remaining reportedly only Finland-oriented. There are, however, no major indications of increased future international activity. Of the ten governmental companies that disclosed this information, all were launched operating only within Finland - one half even limited to a regional market. In 1997, two of ten reported a mandate for international operations, and as many as five (50%) of them projected to cover international markets in the future.

TABLE 27 Where do the Finnish respondents (geographically) operate (1997)?

MARKET FOCUSED:	Finnish corporate respondents – In the company's: *past (start)*	*present*	*future (est.)*	Finnish governmental respondents – In the company's: *past (start)*	*present*	*future (est.)*
EU+FSU	0	0	↑1	0	1	↑2
EU	0	↑1	1	0	1	↑2
FSU	2	3	2	0	0	↑1
Finland	5	↓3	3	5	4	↓2
regional	0	0	0	5	4	↓3

Survey 1997

5.3.2 Value adding

Value-adding is another stage of the venture capital process towards which great expectations and requirements are placed by the industry's stakeholders (e.g., entrepreneurs and government). They have interests that differ from each other as well as from those of the venture capitalists (as was established in chapter 3.1.1). Entrepreneurs are interested in sharing their risks with someone from the outside, but not their control over operations. Governments are

interested in new jobs, not in whether money is made while creating such. But then again, what is value-adding to the venture capital companies?

To as many as 71% of the entrepreneurials and 78% of the corporates (in America) value-adding stands for enhancing the value of their own holdings (see appendix 6: Table P). Interestingly enough, for no less than one half of the respondents in all the Finnish samples in 1992 and 1997 - both corporate and governmental - adding value to own holdings is (reportedly) a side effect, at best. It is also interesting that none of the American corporates and only 14% of their Finnish peers in 1992 (none in 1997) report that they are in business to add value to the strategic capabilities of their funders. Since many of the companies in the three corporate samples are actually captive corporate players, it is out-striking that so few indicate a captive standing towards value-adding. Or then they misread the funder-concept of the study; that it for captive companies often refers to the controlling owner, i.e., the venture capitalist. For captive firms the owner, the venture capitalist, is often the only funder.[162]

When asked to rate the influence of their value-adding work on the investee-businesses, venture capital companies were surprisingly one-minded (see appendix 6: Table Q). Three of the four groups in 1992 gave participation in strategic planning the highest and corporate governance the second highest average score. Only the American corporate respondents gave these an opposite ranking. Also, it was somewhat interesting to discover that all groups but the entrepreneurials indicated, on average, more participation in R&D than general management. Additionally - unlike the entrepreneurials and the governmentals - both of the Finnish and the American corporates also ranked participation in production higher than in general management. These findings can be read as signals of a greater interest of the corporate vs. the entrepreneurial players in the technological solutions of their investees, given the strategic interests of many of their corporate owners.

By 1997, the relative ranking of influence on corporate governance at investee-businesses had dropped from second (in 1992) to fifth position among the governmental players (see appendix 6: Table R). Perhaps the privatisation programme publicised by the Finnish government after the 1997 survey was, in part, based on a perceived loss or lack of investee-control by government-owned venture capital companies. Apart from a weak signal of statistical significance when comparing the absolute (not relative) ratings on participation in R&D - where the corporates report less absolute influence than the governmentals (as in 1992) - the figures for 1997 are in line with those of 1992. The drop in perceived influence on corporate governance for the governmentals remains the most noteworthy development, however.

Looking at how the differently-owned venture capital companies rate their value-adding roles in relative importance, entrepreneurial companies, on one hand, and Finnish corporates, on the other, represent extremes (see table 28). The entrepreneurial companies address, somewhat more than the other

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162 Nevertheless, it seems that still in 1997 venture capitalism in Finland had a much softer face with regard to the players' own profiting interests than in America.

three groups, their role as financiers, and their role as business consultants somewhat less than the others. The Finnish corporates address their role as a source of professional contacts (auditors, lawyers, bankers) more and their role as a sounding board less than the other three groups. It is interesting to note how strongly both American groups underscore their role as a sounding board when compared with their Finnish colleagues. This works as an evidence of the possibility that 'hard', straightforward profit-seeking value-adding objectives do not directly convert into a 'harder' or 'colder' approach to the investee entrepreneurs; in fact, quite the opposite.

TABLE 28: Relative importance of value-adding roles (1992)

RELATIVE IMPORTANCE OF VALUE-ADDING RELATED ROLES			SURVEY 1992
Entrepreneurial AMERICA	Corporate AMERICA	Corporate FINLAND	Govt FINLAND
1. Sounding board	Sounding board	Business consultant	Business consultant
2. **Financier**	Business consultant	**Source/prof. contacts**	Sounding board
3. **Business consultant**	Coach/mentor	Financier	Coach/mentor
4. Coach/mentor	Financier	Coach/mentor	Financier
5. Source/prof. contacts	Source/prof. contacts	**Sounding board**	Mgmt recruiter
6. Mgmt recruiter	Mgmt recruiter	Mgmt recruiter	Source/prof. contacts
7. Friend, confidant	Friend, confidant	Friend, confidant	Friend, confidant
8. Source/ind. contacts	Source/ind. contacts	Source/ind. contacts	Source/ind. contacts

It is also noteworthy that the entrepreneurial respondents rate - on absolute terms - the importance of their value-adding roles the highest among the four groups in each but one role (see appendix 6: Table S). Only in the business consultant role they fall behind the governmentals (means 4.44 vs. 4.50, respectively). In fact, the entrepreneurial venture capital firms hold three of the four highest ratings in absolute importance (see appendix 6: Table T).

5.3.3 Exiting

Historically, exiting is the least explored and the least underlined of the four stages of the venture capital process. As was established in chapter 3, exiting expectedly stands for the ultimate fulfilment in the strategy logic of a venture capitalist. There is reason to believe that the case is not so straightforward, however. As was established in chapter 5.2.2, venture capitalists are driven by different missions. For some, direct financial returns derived from the exiting stage are no make-or-break question. Herein, differences in utilisation of the various *stakeholder groups* as well as the different *exit avenues* are being explored for traits on differences in strategy logic between the differently-owned venture capital companies.

When analysing to which extent the differently-owned venture capital companies lean on their stakeholders when exiting is pursued, there is evidence that the Finnish players, corporates in particular, relied (in 1992) on commercial banks more than their American colleagues (see appendix 6: Table N).

However, whereas both Finnish groups ranked banks number one for entering, the corporates ranked them second and the governmentals a shared fourth for exiting. Investment banks are ranked number one by both American groups, while such are ranked second by the governmentals and only fourth by the Finnish corporates. Interestingly enough, other venture capital firms appeared to be the number one reference group for the governmentals, in 1992, while outside independent investment consultants were number one for the Finnish corporates.

In 1997, other venture capital firms were ranked number one stakeholder by both Finnish groups at the exiting stage (see appendix 6: Table O). For both, banks and insurance companies ranked second. The corporates, for whom in 1992 independent investment consultants had played the leading reference role when exiting, dropped their ranking to fourth by 1997. Considering the validity of the 1997 corporate responses, it is noteworthy that only five (of the total of nine) corporate companies disclosed this information.

Looking at the use of exit avenues (see table 29) in 1992 and 1997, there are a few notable differences. Before going into any depth thereof, it is worth pointing out that, in 1992, Finland had just reached an almost deadly end of a growth cycle during which the OTC market had been established and the IPO market activated. The period was, however, by no means directly comparable with that ended in America. In fact, venture-backed IPOs were extremely scarce prior to 1997, which could be said to have marked a change in the industry atmosphere and culture towards this traditional characteristic of the American market. Comparing the two American groups, no significant differences can be found. The corporates appear to have landed into liquidation situations somewhat more often than the entrepreneurials, whereas trade sales have reportedly played a somewhat bigger role in exiting for the entrepreneurials. What is truly interesting is the fact that none of the American corporates report cases where their funders had been acquiring their investees.

In the difference between the American and the Finnish respondents, the development status of the capital market clearly shows. In 1992, none of the Finnish respondents reported successful IPOs, whereas the figures for the corporate players in 1997, resemble those of their American peers from 1992. Besides evidence of the progress of the Finnish playground, the table provides interesting information on the differences between Finnish corporate and governmental respondents.

The fact that a majority of both *cash* and *cases* in both 1992 and 1997 reportedly derived from MBOs and MBIs for the governmental venture capital firms, underlines the foundation of their strategy logic - which relates to achieving indirect, rather than direct financial returns. Conversely, the governmentals report significantly less activity related to IPO avenue than the corporates do. The sale of the holdings (back) to investee management - as a primary exit avenue (as seemed to be the case for the governmental players still in 1997) - testify of a markedly low profiting ambition. Also, in 1997, reportedly an average of 26.5% of the cases backed by governmental players end up in liquidation (vs. 7.1% of the cases backed by the corporates).

TABLE 29 Historical use of various exit avenues (1992, 1997)

HISTORICAL USE OF VARIOUS EXIT AVENUES	AMERICA 1992 Entrepreneurial			Corporate			FINLAND 1992 Corporate			Governmental				FINLAND 1997 Corporate			Governmental			ANOVA
	Mean	n/n	SD	Mean	n/n	SD	Mean	n/n	SD	Mean	n/n	SD	*P-value*	Mean	n/n	SD	Mean	n/n	SD	*P-value*
(n/n = number of respondents that have used the avenue in question/total number of respondents that disclosed exit information)																				
Proportion of "cash"																				
IPOs (inv. buyers)	**43.1**	21/27	31.33	**52.6**	7/7	20.32	**0.0**	0/8	0.00	**0.0**	0/3	0.00	*0.000****	**58.1**	5/7	43.75	**8.3**	1/6	20.41	*0.027***
Trade sales (corp.)	**42.7**	27/27	28.72	**30.7**	7/7	20.90	**40.0**	5/8	40.00	**20.0**	2/3	22.91	*0.540*	**17.1**	4/7	18.90	**15.0**	4/6	15.49	*0.829*
Liquidations	**5.9**	13/27	8.61	**11.0**	4/7	11.99	**19.4**	3/3	28.34	**31.7**	2/3	35.47	*0.033***	**11.4**	1/7	30.24	**9.2**	3/6	11.14	*0.866*
Other VC firms	**3.3**	4/27	11.83	**2.9**	1/7	7.56	**12.5**	1/8	35.36	**0.0**	0/3	0.00	*0.572*	n.a.			n.a.			
MBOs/MBIs	**3.2**	8/27	6.04	**2.9**	2/7	4.38	**28.1**	5/8	37.41	**48.3**	3/3	45.37	*0.000****	**12.4**	3/7	25.78	**60.8**	6/6	27.82	*0.008****
Own funders	**1.9**	3/27	6.07	**0.0**	0/7	0.00	**0.0**	0/8	0.00	**0.0**	0/3	0.00	*0.665*	**0.9**	1/7	2.27	**6.7**	1/6	16.33	*0.369*
Total	100.0	%		100.0	%		100.0	%		100.0	%			100.0	%		100.0	%		
Proportion of "cases"																				
IPOs (inv. buyers)	**33.1**	18/23	24.63	**41.3**	8/8	25.88	**0.0**	0/10	0.00	**0.0**	0/4	0.00	*0.000****	**47.9**	5/7	44.52	**2.5**	1/6	6.12	*0.032***
Trade sales (corp.)	**45.6**	22/23	26.43	**31.3**	8/8	21.84	**38.3**	7/10	33.53	**21.3**	3/4	17.50	*0.300*	**21.4**	4/7	24.78	**12.7**	4/6	12.36	*0.450*
Liquidations	**9.4**	11/23	11.60	**22.5**	7/8	12.54	**15.5**	4/10	21.66	**21.8**	3/4	20.95	*0.146*	**7.1**	1/7	18.90	**26.5**	5/6	23.61	*0.129*
Other VC firms	**0.4**	1/23	1.67	**2.5**	1/8	7.07	**10.0**	1/10	31.62	**0.0**	0/4	0.00	*0.402*	n.a.			n.a.			
MBOs/MBIs	**9.6**	9/23	16.92	**2.5**	2/8	4.63	**36.2**	7/10	33.52	**57.0**	4/4	33.66	*0.000****	**20.0**	3/7	32.15	**52.7**	6/6	31.51	*0.092**
Own funders	**1.9**	3/23	5.73	**0.0**	0/8	0.00	**0.0**	0/10	0.00	**0.0**	0/4	0.00	*0.512*	**3.6**	1/7	9.45	**5.7**	1/6	13.88	*0.753*
Total	100.0	%		100.0	%		100.0	%		100.0	%			100.0	%		100.0	%		

p < 0.100, p** < 0.050, p*** < 0.010, p*** < 0.001*

5.4 Linking the *faces* with the *phases*: Towards archetypes of venture capitalist strategy logic

At the end of the day, do the different *phases* of the venture capital process represent *more unifying* or *more differentiating* factors of strategy logic to the different *faces* of venture capitalism? So far in the study, several pieces of evidence point at one or the other direction. And, as was laid out early on, no clear scientific evidence was expected in either direction. Rather, should no such evidence rule out the possibility that the different stages of the venture capital process are more differentiating than unifying factors for the strategy logic of differently-owned venture capital companies, the benefit of the doubt would have been established and, thereby, the mission of the thesis fulfilled.

This chapter will present the results from the sections of the 1992 and the 1997 surveys in which the respondents were asked to rate and rank - from various angles - the importance of the different stages of the venture capital process for their business. The intent is to analyse and evaluate the role each stage plays in the strategy logic of each venture capitalist type. Again, the main interest will be placed on comparing the American entrepreneurial and corporate samples with each other, on one hand, and the Finnish corporate and governmental samples with each other, on the other.

The three main marketing related tasks of a venture capital company - identified in chapter 3 and labelled as fund-raising, entering, and exiting - are being referred to herein as (i) the marketing of investment vehicles to funders, (ii) the marketing of funds to suppliers, and (iii) the marketing of saleable investee firms (the divestees) to consumers. Simplified, the plan is to established whether the differently-owned venture capital companies place significantly differing weights and values on these. At simplest, it could be established that a type A venture capitalist is focused on marketing task X, a type B venture capitalist on marketing task Y, and type C on task Z. This, in turn, would support the conclusions and proposition-building that venture capitalism comprises of more than business (or industry). Should such proposal become subscribed to by follow-on research, the implications to venture capitalism, and our understanding thereof, would be significant.

Starting with the responses to yes-or-no questions regarding engagement with the three marketing tasks gives a good preview of whether or not the quest is empirically founded. As can be learned from table 30, 71% of the entrepreneurial companies engage in the marketing of investment vehicles to potential new funders. Their corporate (American) colleagues are not equally engaged in this marketing task - as many as 75% (reportedly) do *none* of it. They are quite unanimous about the two other marketing tasks, however. The two Finnish groups are equally split on the first marketing task, and equally unanimous on the second task. Regarding the third marketing task, the Finnish corporates are interestingly split 50-50, whereas the governmentals indicate strong engagement in the marketing of divestees to consumers.

In conclusion, fund-raising seems to have a different weight or role in the business of both the American and the Finnish comparison-pairs.

TABLE 30 Engagement with the three marketing tasks (1992)

ENGAGEMENT IN MARKETING	AMERICA 1992 Entrepreneurial			Corporate			FINLAND 1992 Corporate			Governmental		
Is your venture capital company marketed to *funders*?	yes	24	**71%**	yes	2	25%	yes	9	60%	yes	3	30%
	no	10	29%	no	6	75%	no	6	40%	no	7	70%
	total	34	100%	total	8	100%	total	15	100%	total	10	100%
Is your venture capital company marketed to *suppliers*?	yes	20	59%	yes	6	66%	yes	10	**71%**	yes	5	63%
	no	14	41%	no	3	33%	no	4	29%	no	3	38%
	total	34	100%	total	9	100%	total	14	100%	total	8	100%
Are your portfolio companies marketed to *consumers*?	yes	19	70%	yes	6	67%	yes	6	50%	yes	8	**89%**
	no	8	30%	no	3	33%	no	6	50%	no	1	11%
	total	27	100%	total	9	100%	total	12	100%	total	9	100%

The information from table 30 above is further enriched by the information provided in table 31. Of the entrepreneurial respondents as many as 91% agreed that marketing investment vehicles to funders are as important to their business (venture capitalism) than any marketing of a product is to any business. Oly 38% of their corporate colleagues agreed. Both of the Finnish groups were in clear agreement herein, which is interesting, since only 30% of the governmentals indicated engagement in this marketing task. Perhaps even more interestingly, while 82% of the entrepreneurial respondents agreed that the marketing of divestees to consumers is of equal importance to their business, only 33% of the American corporates and 46% of the Finnish corporates agree on the same. The differences in the perceived importance of fund-raising and entering to their business discovered between the American entrepreneurial and corporate respondents are extremely interesting - even if statistically 'symptomatic' at best.

The respondents were asked to rate the three marketing tasks in relative importance. Not surprisingly (given that 75% of the American corporates reportedly *do not* engage in the marketing of investment vehicles), a statistically significant difference was discovered in how the American groups rated the importance of *fund-raising* (see table 32). While fund-raising was to the entrepreneurial respondents by far the most important marketing challenge, entering posed the most important challenge to the other three respondent groups. Interestingly enough, the Finnish corporates are the only group among all four to rank marketing of divestees to consumers - exiting - (a shared) number one challenge. It is noteworthy, however, that the entrepreneurial respondents gave nevertheless the highest *absolute* rating to exiting. In fact, three of the top five *absolute* ratings to any marketing tasks were given by the entrepreneurials and, interestingly, the two lowest (of the total of twelve) absolute ratings were given by American corporates (see appendix 6: Table U).

TABLE 31 Position regarding the importance of the three marketing tasks (1992)

Statement: *"The following marketing tasks are as important to your business as any marketing of a product is to any business"*

POSITION REGARDING IMPORTANCE OF THE MARKETING TASKS	*(rated 1-5: 1 for least, 2-4 for average, and 5 for most important marketing task)* Entrepreneurial AMERICA Important?	Mean	SD	n	Corporate AMERICA Important?	Mean	SD	n	Corporate FINLAND Important?	Mean	SD	n	SURVEY 1992 Governmental FINLAND Important?	Mean	SD	n	*ANOVA P value*
Marketing *investment*	agree 91%	**4.29**	0.91	34	agree 38%	**3.25**	1.58	8	agree 64%	**3.71**	1.20	14	agree 60%	**3.60**	1.58	10	*0.077**
vehicles to funders	disagree 6%				disagree 38%				disagree 14%				disagree 20%				
Marketing *funds vehicles*	agree 54%	**3.74**	1.04	35	agree 33%	**3.33**	1.12	9	agree 46%	**3.38**	0.87	13	agree 70%	**3.60**	1.26	10	*0.627*
to suppliers	disagree 11%				disagree 22%				disagree 15%				disagree 20%				
Marketing *portfolio interests*	agree 82%	**4.03**	1.03	34	agree 33%	**2.89**	1.05	9	agree 46%	**3.46**	0.97	13	agree 55%	**3.67**	1.22	9	*0.032***
to consumers	disagree 12%				disagree 33%				disagree 15%				disagree 18%				

p < 0.100, p** < 0.050, p*** < 0.010, p*** < 0.001*

TABLE 32 Rating the importance of the three marketing tasks (1992)

RATING THE THREE MARKETING TASKS	*(rated 1-5: 1 for least, 2-4 for average, and 5 for most important marketing task)* Entrepreneurial AMERICA Importance	Mean *(rank)*	SD	n	Corporate AMERICA Importance	Mean *(rank)*	SD	n	Corporate FINLAND Importance	Mean *(rank)*	SD	n	SURVEY 1992 Governmental FINLAND Importance	Mean *(rank)*	SD	n	*ANOVA P value*
Marketing investment	most 45%	**4.15**	0.91	33	most 11%	**2.78**	1.39	9	most 15%	**3.38**	1.26	13	most 0%	**2.89**	1.36	9	*0.002****
vehicles (e.g.. funds)	average 55%	***(rank 1)***			average 67%	*(rank 2)*			average 70%	*(rank 3)*			average 78%	*(rank 3)*			
to potential *funders*	least 0%				least 22%				least 15%				least 22%				
Marketing saleable	most 33%	**3.79**	1.08	33	most 13%	**2.75**	1.49	8	most 46%	**3.62**	1.50	13	most 33%	**3.33**	1.32	9	*0.209*
portfolio companies	average 64%	*(rank 2)*			average 63%	*(rank 3)*			average 46%	***(rank 1)***			average 67%	*(rank 2)*			
to potential *consumers*	least 3%				least 25%				least 8%				least 0%				
Marketing funds and	most 24%	**3.67**	1.05	33	most 33%	**3.78**	1.30	9	most 8%	**3.62**	0.96	13	most 67%	**4.22**	1.39	9	*0.582*
value-adding services	average 76%	*(rank 3)*			average 56%	***(rank 1)***			average 85%	***(rank 1)***			average 22%	***(rank 1)***			
to potential *suppliers*	least 0%				least 11%				least 8%				least 11%				

p < 0.100, p** < 0.050, p*** < 0.010, p*** < 0.001*

The respondents were also asked whether or not they could think of any other than the three marketing tasks that their companies are engaged in. Quite a large percentage of respondents in each of the four owner-type categories indicated that such other tasks existed. Next, the respondents were asked whether or not these other tasks were *more important* than the three related to fund-raising, entering, and exiting. Four of the eleven entrepreneurial respondents that had indicated that there were such other tasks found these other tasks more important than the three (see appendix 6: Table V). As altogether 33 entrepreneurials had disclosed their rating of the three tasks, one third were able to think of other tasks and 12% found such tasks more important. As many as two thirds of the altogether nine governmentals disclosing their rating of the three tasks, could think of some other task and one (or 11%) found such other task more important. None of the corporates found other tasks more important than the three (as many as 22% of the American and 31% of the Finnish corporates had been able to list other marketing tasks).

The four other tasks included among the top-three venture capital marketing tasks by the entrepreneurial players comprised marketing (i) among peers and trade allies regarding referrals, (ii) to brokers and M&A specialists regarding protection of fees, (iii) among referral sources, (iv) own ideas to investee management during value-adding. These valuable notions highlight the focus of the agenda of an entrepreneurial venture capitalist. Similarly, the one other task included among the top-three venture capital marketing tasks by a governmental player - marketing advisory services to other firms in addition to portfolio companies - sheds light on the agenda of this player type.

In 1997 venture capital companies in Finland were again asked to rank the three marketing tasks in relative importance. This time the respondents were urged to give each task a different rank (in 1992 the tasks were rated on a scale of 1-5). Marketing funds to suppliers (entering) was again clearly established as a key challenge among the governmental players and, as can been seen from table 33, equally clearly exiting was now ranked the least important challenge by this group. The corporates were less unanimous. The two other marketing tasks received exactly similar rating by the corporates. Comparing 1997 with the ratings from 1992, fund-raising had replaced exiting as the second most important marketing challenge for the governmentals, and reached the same rating with exiting for the corporates. In conclusion, fund-raising had gained importance at the expense of exiting in Finland.

Again, the respondents were asked whether or not they could think of other marketing tasks besides the three. This time two of the eight corporates that disclosed their ranking of the three marketing tasks, and four of the eleven governmentals that did the same, found such other marketing tasks to be more important than the three (see appendix 6: Table W). The corporates disclosed: (i) networking at parent company level and (ii) marketing tasks related to re-leasing activity among their top-three marketing tasks. The more important tasks for the governmentals consisted of: (i) seeking public listing for their own shares, (ii) explaining to public what venture capital is, (iii) enhancing stable growth of the Finnish economy, and (iv) developing other firms in addition to

the portfolio companies in the venture capital company's home region. Even these perspectives widen the understanding of differences in strategy logic between differently-owned venture capital companies.

TABLE 33 Ranking the three marketing tasks in relative importance (1997)

IMPORTANCE OF THE THREE GIVEN MARKETING TASKS	*(rated 1-3: from least to most important)* Corporate Importance		Mean (rank)	SD	n	Governmental Importance		Mean (rank)	SD	n	FINLAND 1997 *ANOVA P value*
Marketing funds and value-adding services to potential *suppliers*	most	50%	**2.37**	0.74	8	most	73%	**2.64**	0.67	11	*0.435*
	second	38%	*(rank 1)*			second	18%	*(rank 1)*			
	third	13%				third	9%				
Marketing investment vehicles (=funds) to potential *funders*	most	29%	**1.86**	0.90	7	most	30%	**1.90**	0.88	10	*0.923*
	second	29%	*(rank 2)*			second	30%	*(rank 2)*			
	third	43%				third	40%				
Marketing saleable portfolio companies to potential *consumers*	most	29%	**1.86**	0.90	7	most	0%	**1.50**	0.53	10	*0.317*
	second	29%	*(rank 2)*			second	50%	*(rank 3)*			
	third	43%				third	50%				

Still not convinced of how the venture capitalists actually perceive their main product and key market segment, and whether they perceive it (on relative terms) more similarly or more differently, the respondents were in 1992 asked for a direct assessment of products and markets (for further detail, see appendix 6: Tables X and Y). As illustrated by the tables below, where the (relatively) most differing responses are printed in bold and trends by arrows (indicating major weakening/strengthening), a direct quest also produced results.

Regarding the conceptualisation of product (see table 34), some change in the ranking of the products takes place between the time of foundation and the time of survey. While capital seems to have been the most emphasised product around the time of venture capital company foundation, it was one of the least emphasised around the time of the survey. The meaning of the venture capital company management team, conceptualised as an element of the product seems to have been on the rise - and most so for the Finnish corporates. At the time of the survey, three of the four groups rank value-adding and venture management (in this order) as their conceptualisation of the most important elements of their company's product. The governmental are the odd one out. For them, venture management had been number one product from day one and value-adding the least important one all along. The governmentals are also the only group for whom the relative value of capital - in conceptualisation of product - has not decreased.

TABLE 34 Discovering the product of the venture capital company (1992)

EVALUATING THE "PRODUCTS" OF THE VC COMPANY			SURVEY 1992
Entrepreneurial AMERICA	Corporate AMERICA	Corporate FINLAND	Govt FINLAND
At foundation:			
1. Value adding	Capital	Capital	**VC firm mgmt**
2. Capital	Value adding	Value adding	Capital
3. VC firm mgmt	VC firm mgmt	Portfolio firms	Portfolio firms
4. Portfolio firms	Portfolio firms	VC firm mgmt	**Value adding**
At time of survey:			
1. Value adding	Value adding	Value adding	VC firm mgmt
2. VC firm mgmt	VC firm mgmt	VC firm mgmt ↑	**Capital**
3. Portfolio firms	Capital ↓	Capital ↓	Portfolio firms
4. Capital ↓	Portfolio firms	Portfolio firms	**Value adding**

Regarding markets, there is much less change between the time of foundation and the time of survey than was the case with the product. Both of the American groups emphasise funders as their key market segment around the company foundation (see table 35). As their own business matures, suppliers replace funders among the entrepreneurials which is not the case with the corporates. For the two Finnish groups, suppliers remain number one segment. Interestingly, around their time of foundation, governmental companies conceptualised government as their second most important market segment (ranked the least important by all the other groups) and funders their least important market segment (ranked first by both of the Americans and second by their Finnish colleagues). At the time of the survey, government and funders had changed position in the ranking or conceptualisation of market segments even for the governmentals.

TABLE 35 Discovering the market of the venture capital company (1992)

EVALUATING THE "MARKETS" OF THE VC COMPANY			SURVEY 1992
Entrepreneurial AMERICA	Corporate AMERICA	Corporate FINLAND	Govt FINLAND
At foundation:			
1. Funders	Funders	Suppliers	Suppliers
2. Suppliers	Suppliers	Funders	**Government**
3. Consumers	Consumers	Consumers	Consumers
4. Government	Government	Government	**Funders**
At time of survey:			
1. Suppliers ↑	**Funders**	Suppliers	Suppliers
2. Funders	Suppliers	Funders	Funders ↑
3. Consumers	Consumers	Consumers	Consumers
4. Government	Government	Government	Government ↓

In pursuit of digging deeper yet into the strategy worlds of the differently-owned venture capital companies, the respondents were asked in 1992 about their attempted innovation relative to industry practices concerning the phases of the venture capital process. As can be noted from table 36 (see appendix 6:

Table Z for more detailed information), the entrepreneurial venture capital companies, on average, seek for their competitive advantage by developing their value-adding strategies. Since as many as 41% of them place top value on seeking it right here, this is where they presumably think they have the most at stake.

TABLE 36 Attempted innovation by the venture capital company (1992)

ATTEMPTED INNOVATION RELATIVE TO INDUSTRY PRACTICES			SURVEY 1992
Entrepreneurial AMERICA	Corporate AMERICA	Corporate FINLAND	Govt FINLAND
1. **Value-adding**	**Deal negotiation**	Deal search	Deal search
2. Deal search	Value-adding	Value-adding	Value-adding
3. Deal negotiation	Exiting	Deal negotiation	Deal negotiation
4. Fund-raising	Fund-raising	Exiting	Fund-raising
5. Exiting	**Deal search**	Fund-raising	Exiting

American corporates place their best bets on deal negotiation strategies. To serve their most crucial interests, it seems, deal structures are the make-or-break issue. While the entrepreneurial companies place a significant effort on deal search strategies (ranked number one by both of the Finnish groups), the American corporates stretch out the least here. They seem to be far less concerned for personalising their deal flow than for the terms for which the deals are closed. There are no major differences in the *relative rankings*, per se, between the Finnish groups. But when we look at the *absolute ratings* for attempted innovation. In every category, the corporates indicate a stronger pursuit for innovation and new competitive advantages than their governmental colleagues. In fact, the 'average mean' - which indicates the venture capitalist type's general competitive nature or hunger for innovation - is the highest for the Finnish corporate firms (3.56), followed by the Americans (entrepreneurials at 3.44 and the corporates at 3.14) - being the lowest for the Finnish governmental companies (2.90).

6 STRATEGY LOGIC AND CHANGE: FOLLOWING VENTURE CAPITAL COMPANIES THROUGH CHANGE OF OWNER-TYPE

6.1 Introduction to the case study

In this chapter, linkages between the ownership and strategy of venture capital companies are examined by following the venture capital industry in Finland, in general, and selected venture capital companies, in particular, *through leaps* of ownership, e.g., from corporate to entrepreneurial ownership or *vice versa*. Given the global reach of the study, and the understanding that market conditions make a big difference to the prevailing forms of venture capital in any one country, case selection took place herein, first, between different *markets*. Only secondarily, the selection concerned choice between particular companies as research objects or *cases within*. In this research, Finland was the natural choice for case economy by all imaginable criteria.

In venture capital, in particular, the developments within particular firms have to be evaluated against their national market environment, past and present. In other words, the firms cannot be extracted from the historic contexts of their markets. This is not to say that company-specific case studies are irrelevant in venture capital research; quite the contrary. It is simply to underscore that venture capitalists should not be benchmarked against one another *outside* the contexts of their local historic, cultural, and market conditions. An environment analysis from the *venture capitalist's perspective* should precede any such attempt.[163]

If Finland was the natural choice for case economy in this research, the same applies to the cases *within*. Sponsor Oy (est. 1967) – *Sponsor Capital Oy* (a different legal person) since 1997 – was Finland's first venture capital firm, and

[163] Which is not necessarily easy, in the light of the notion that little attention has been placed in analysing and understanding the venture capitalist's perspective or point of view. Regarding the present study, an effort towards such an analysis is available upon request.

the leader and pioneer of the single LTD structure-based *kehitysyhtiö* era. Sponsor is also the only venture capital firm in Finland that has experienced all the main owner-types (governmental, corporate, and entrepreneurial). CapMan Capital Management Oy (est. 1988) is the leader and pioneer of the modern era. In 1989, CapMan raised Finland's first limited-life LP fund vehicle involving outside funders and, in an 1993 MBO, converted from corporate to entrepreneurial ownership. It took four years, however, before Sponsor and others followed CapMan's lead towards entrepreneur-driven structures.

Besides Sponsor and CapMan (the *cases within*) on which interviews have been conducted, the story of *Mancon Oy* (1978-1989) will be followed - from a greater distance, though; based mainly on public material available in literature and the media.[164] Mancon was Finland's first private sector controlled venture capital company and the industry's second. Years before ending up in bankruptcy in 1989, Mancon started *climbing up* the tree, i.e., to convert from being fully management-owned towards increasingly institutional owner base. The rest of the field *has been* on a consistent move *down the tree*.[165]

Concerning Sponsor and CapMan, whose *capitalists* and *capitalism* are under the keenest scrutiny in this chapter, several anonymous quotes will be presented in the course of this chapter. These are excerpts from recorded interviews with selected individuals centrally representing the lives of the two companies, past and present. Because of the nature and role of this exercise as a control mechanism for the framework and the archetypes of venture capitalist strategy logic, it has been deemed important to present many of the recorded comments in their entirety; and not merely as interpreted by the researcher. The quotes are presented *anonymously* largely because the identification of source (herein) would serve *no research related* purpose.

Nine structured interviews were conducted with five different individuals in 1993, 1997, and 2000. Five of the interviews were taped and four were recorded by taking hand notes. An average interview lasted 45-60 minutes. Before the first interview with each person an interview outline was sent to the interviewees beforehand (interview outline as appendix 7).

6.2 The first coming of venture capitalists: The *kehitysyhtiö* era

Government banks, internationally as well as nationally, seek to develop the financial market of their target economy and, where and when deemed necessary, temporarily participate in the building of market institutions therein. In emerging market conditions, a more participatory role is often required. This is clearly visible in the mandate and operations of, e.g., the International Finance Corporation (IFC) of the World Bank Group.

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164 The case study also derives from (*not repeats*) Seppä (1989) and Seppä and Näsi (1991).

165 This is not accounting for those venture capital companies which became publicly listed during the mid-to-late 1980s and which had been *established institutional* to begin with.

6.2.1 *Governmental* shaping of strategy logic

6.2.1.1 Playing an unwanted monopoly (1967-1978)

Back in the 1960s, the financial market in Finland was strictly regulated and, in a word, inactive. The availability of risk capital was minuscule. Basically, the only potential source of capital was the banking sector. The banks, in turn, had little incentive to develop alternative sources to debt instruments, for the simple reason that demand for capital through the only existing source - themselves - always exceeded supply at the fixed interest rates of those days. Additionally, the general political and economic situation raised concern.

During the late 1960s, leftist radicalism swept across Western Europe, particularly France. Perhaps due to its difficult geopolitical standing throughout the post-war period, Finnish society experienced less *increase* of criticism towards the capitalistic system.

> "But also in Finland, during the late 1960s, a politically significant change in public view took place... Not just within the communist party but also within the social democrats it was concluded that 'capitalism was cracking'." (Jakobson 1983: 149.)

In the 1966 parliament election, communists and socialists gained a simple majority of seats (103 versus 97) and, uniquely for a western democracy, the communists were invited to co-form the government. Economically, as strongly pointed out by Klaus Waris, the president of the Bank of Finland, the country was heading into a severe economic crisis; the balance of payments was continuously at a deficit, the currency reserve was shrinking, and foreign debt increasing. President Kekkonen concluded that the communists had to be invited to the government to secure stability. There were certain concerns for the consequences to Finland's perceived neutrality. (Jakobson 1983: 157-160.) Nevertheless, venture capitalism (as a *process* rather than as a *business*) was imported into the country around that time. Also, importantly, Finland joined the OECD in 1968.

In 1967, Finland was celebrating her 50th anniversary of sovereign independence under clear political pressure, both foreign and domestic. At this hour, the government established two institutions that would foster the country's ailing enterprising activity into the future: The venture capital firm *Sponsor* and the Finnish National Fund for Research and Development *Sitra*.

> "The idea of investing risk capital in prospective young enterprises is actually not all that new. Already in 1966 the *kehitysyhtiöidea* was imported to Finland from America by two foresighted individuals in the Bank of Finland, Jaakko Lassila and Heikki Valvanne." (Rosenlew 1985).

Dr. Jaakko Lassila, Sponsor's founding president to-be, had earlier in the decade concluded a two-year mission at the World Bank, in Washington, D.C., where he had been sent by Klaus Waris, the president of the Bank of Finland (Hosia 1985: 156). Brainstorming sessions in 1966 between Lassila, then president of the Industrialisation Fund, and Valvanne, director and member of

the board of the Bank of Finland, referred to above by Rosenlew (1985), led to the following conclusions:

> "After looking at what was being done in America, also Sweden, it was evident that the [Finnish] SME sector had three basic problems: innovation activity for new product development was poor, management skills were poor even in good companies, and there was no availability of venture capital. The conclusion was to establish a company that would finance such innovation activity, and make venture capital investments in the most prospective companies. Early on, majority holdings were planned to be targeted, due to expected conflicts of interests with controlling private owners."

Klaus Waris, president of the Bank of Finland, strongly subscribed to the rationing and, first, influenced on the Bank to become committed as the main owner of such new entity. Second, he used his authority to bring along Finland's major private-sector financial institutions, and the industry, as co-founders. In 1967, Sponsor Oy – the first *kehitysyhtiö* – was established.[166]

Giving-of-birth to strategy logic

According to a Swedish example, Sponsor was founded as a single LTD structure. In such a firm, the one who subscribes for the majority of shares, i.e., who contributes the majority of capital, is the venture capitalist as long as he holds the shares and participates in additional issues of stock. In other words, as long as there is only one class of shares, the venture capitalist always has more money invested in the firm than all the funders combined. This was the case with Sponsor, when the company was established in 1967. As the Bank of Finland subscribed for 60% of Sponsor's FIM 10 million founding equity it was the *venture capitalist* and the other founders were the *funders*.

Sponsor was not established primarily to pursue any traditional capitalist mission, such as phenomenal direct financial returns, but rather to develop Finland's financial system.

> "The starting point was general political in the sense that a gap in the financial system was pursued to be fulfilled by creating a company that would support prospective SMEs by providing them with management services, the necessary risk capital, and also innovative product ideas. [Sponsor's] product was a combination of these three things; it was actually selling a development input to business firms. Businesses that were analysed prospective, but suffered from narrowness in management practices and lack of risk capital, were the clients."

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166 Until 1989, *kehitysyhtiö* was the dominant Finnish umbrella term for all types of venture capital companies. By the end of the 1980s, a conceptual difference was made between a *kehitysyhtiö* (e. development company) and a *riskisijoitusyhtiö* (e. risk investment company); where the former is associated with a preference for majority acquisitions of mature businesses and (structurally) with a single LTD structure; and the latter with more classic investment preferences and the limited-life LP fund structure. During the 1990s, *pääomasijoitusyhtiö* (e. capital investment company) has replaced both expressions as the local umbrella term, while, internationally, *private equity* has largely replaced *venture capital* as the general umbrella term.

But why did *private sector* financial institutions join in as funders of a *governmental* venture capitalist who - clearly - was more driven by economic policy related concerns than by a pursuit to generate maximal financial returns with a promising new business idea?

> "It was more, should we say, in quotes: 'Patriotic enthusiasm over a good cause'. Klaus Waris influenced on the commercial banks in such a way that made them join the effort, and when the industry associations were briefed-in, they sort of understood the need behind and joined, too."

Regardless of all good intent, getting started with investment work was not easy. At first, Sponsor did not even have an organisation of its own. The company purchased management services from Teollistamisrahasto (hereafter the Industrialisation Fund) - both administrative and investment work. Already during its early years, Sponsor decided to quit its innovation financing activity, which then became concentrated on Sitra.

> "Innovation financing proved to be so complicated that the function was soon terminated. When information on such 'a sponsor company' spread around, inventors of every type and character soon came through all doors and windows."

After Sponsor decided to establish an organisation of its own, it never had any difficulty in attracting talent. At the time, institutional positions (both corporate and governmental) were far more appreciated than entrepreneurial ones.[167] For example, the founding president of Sponsor, Dr. Jaakko Lassila, emerged as the president and CEO of Insurance Company Pohjola Ltd (hereafter Pohjola), Finland's largest equity investor, and Kansallis-Osake-Pankki (hereafter KOP), one of Finland's two dominant banks that are today part of MeritaNordbanken.

Regardless of its majority position, the Bank of Finland was a relatively passive owner. In other words, while the venture capitalist had started out by setting a clear mission and strategic direction to the company, it was apparently no active governor.

> "Early on.. [Sponsor] was actually more a management-driven system than an owner-driven one. The real venture capitalist, if these definitions are used, the Bank of Finland, in fact left the management with free hands... The management was allowed to develop [Sponsor] into the direction of its own choosing. And, admittedly, when thought of as a pure such financial-return driven company, whose mission is to increase the value of its own stock - though the external conditions [growth] of the 1980s helped a lot - Sponsor succeeded extremely well. "

Management-driven change of strategy logic

Sponsor's management used its space. Regardless of a clear majority owner, the company's strategy was management-driven, rather than owner-driven. Eventually, the company reached the stage at which its strategy was in conflict with its ownership.

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[167] In fact, only very recently have there been signs of the opposite (personal observation).

"From that point on it was a search for capital appreciation. In other words, return or return-expectation became the primary criteria... There had been the principle, in the beginning, that investments would not be made in such businesses where a clear competition already existed in the market. This was also for the reason that Sponsor was operated on the side of the Industrialisation Fund and no such situation was wanted in which a Sponsor portfolio company would be in steady competition with an Industrialisation Fund's client. [The investee business] had to be something that could be called new. Later this principle was skipped and Sponsor invested in businesses where its portfolio company could be in fierce competition with other Finnish businesses. Earlier, we had wanted to bypass... businesses where there already was competing production. But later, when direct financial returns where the clear objective, principles such as these had no meaning."

Consequently, Sponsor's strategy logic was not its shareholders' strategy logic. Either the *strategy* or the *ownership* had to change. By 1983, the owners concluded that they were in the wrong place at the wrong time, and sold out.

Regardless of a difficult start, Sponsor succeeded in making quite successful early investments; *Autolava/Multilift Oy* and *Teleste Oy* to name two. But as years went by, says an ex-Sponsor executive: "It was most frustrating to learn that, even after successful value-adding, there was only one acquirer-candidate for an investee company." Foreign ownership restrictions, not to mention Sponsor's national cause and mission, excluded foreign buyers from the list of potential candidates. Due to Finland's regulated capital market and inactive stock market, initial public offerings (IPOs) could not even be dreamed about. In other words, when Sponsor was ready to exit, there was only one potential 'consumer' for the divestee - a class example of a 'buyer's market'. Before too long, it was evident that even a non-financially-driven venture capital company needs *a choice* at the exit stage.[168]

In his insightful address to the Finnish Economic Society (Kansan-taloudellinen yhdistys), Jääskeläinen (1971) criticises the reforms made and institutions established since 1955, with regard to retardation of equity financing in Finland.[169] Particularly the *pension fund reborrowing scheme* (companies' entitlement to inexpensively 'borrow back' the pension contributions derived from their employees) was mentioned with concern, because it kept the pension money off the equity market. Jääskeläinen (1971: 182-184) clearly presents, by using an illustrative example, why and how the high level of corporate indebtedness increases risk aversion, and hence innovation activity. In his judgement, the efforts to develop equity financing in Finland had been limited to amendments of fiscal legislation, "the insufficient effects of which have been predictable in advance."

'Lex Sponsor' (1978)

In the absence of traditional alternative ('external') exit avenues, the government opened up an 'internal' exit avenue by declaring - on an

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168 Says an interviewee: "What has concerned me a lot is the exit question. What is the point in turning an investee superiorly profitable if you cannot sell it?... Thinking about exit is one of the central prerequisites in venture capital, in order to succeed."

169 In 1970, the turnover of the Helsinki Stock Exchange was on a similar level than in 1950.

application basis - *dividend income* from portfolio firms *tax-free*. Technically, a new chapter was added, on 3 November 1978, into the sixth section of the Finnish company tax code (Laki elinkeinotulon verottamisesta 6 §, 1978). The Ministry of Finance was hereby made the gate-keeper of a venture capital industry fiscal incentive. An excerpt from the text of the law amendment below (translation by the researcher, emphasis added):

> "The Ministry of Finance decides based on a corporation's or a co-operative's application whether from the viewpoint of the country's economic life it is *considered to be important* as an entity operating to develop and enhance the investments of the industry. Before its decision the Ministry of Finance has to get a statement from the Board of Industry Development."

Sponsor's application for a tax-free status was approved before year end 1978. Making the connection between Sponsor's exit problems and the tax-exemption programme unavoidable. For nearly six years Sponsor was the only company approved for the tax-free status. Descriptively, the tax-exemption programme, or incentive, was by the mid-1980s referred to as *Lex Sponsor* among Sponsor's industry rivals, and the companies approved for the Lex Sponsor status as *Lex Sponsor companies*. (Seppä 1989.)

According to a Ministry of Finance authority (interviewed for this research project in 1988) Lex Sponsor was not meant to be the legitimisation of the *kehitysyhtiö* industry: Any firm operating to enhance the development and investments of the industry was, principally, eligible for the status. In reality, however, Lex Sponsor resulted in governmental shaping and gate keeping of the industry. An excerpt from the interview below (emphasis added):

> "After Sponsor received the status, a handful of holding companies [less than five] tried to find out how the land lied, but their applications were naturally turned down. These were *ordinary passive investment companies* that failed to convince the ministry of their *active development contribution* potential."

Intentionally or not, the government had established a status of both *financial* and *recognition* value - neither one of which was unimportant in venture capital, and definitely not in Finland in the 1970s. In fact, given Finland's underdeveloped enterprising culture and regulated financial market, such a status had immediate prerequisite value. If not granted the Lex Sponsor status, a new entrant would find itself between hard and rock. Interestingly enough, the same year the corporate tax code was amended with the incentive, the industry's first private company was established. There is no evidence that information of the upcoming fiscal incentive drove the private start-up but 1978, nevertheless, saw an end to Sponsor's unwanted monopoly. On the other hand, the fact that Lex Sponsor remained an incentive for Sponsor only, until 1984, effectively protected Sponsor's *originally* unwanted domination of the industry with another six years.

In conclusion, in Lex Sponsor, a system had become established whereby the government decided which ownership and which strategy, i.e., *which*

strategy logic, made a venture capital company *important* to the economy, in Finland, and which did not. [170]

6.2.1.2 Confronting a *capitalist* adversary (1978-1983)

One of the parties with an early interest in the Lex Sponsor status was Mancon Oy, a private company established (as coincidental as it may be) in 1978. Six years later, in 1984, "after Mancon's ownership base and extent of operations coincided with the ministry's criteria - after a long period of consideration - the company's application was approved" (interview with a Ministry of Finance authority in 1988). Mancon's breakthrough as a Lex Sponsor company set a precedent and was followed by an unforeseen venture capital industry boom.

Mancon Oy had been the second company established in the venture capital field in Finland, but the first founded on private-sector capital. For long, Mancon was the only venture capital company predominantly controlled by an *individual venture capitalist,* Mr. Gustav Rosenlew.

The coming of Mancon: Grooming up strategy logic

The great grandfather of Gustav Rosenlew had established Rosenlew & Co., the predecessor of Oy Rosenlew Ab (the family business), in 1853. Over time, Oy Rosenlew Ab grew into a major wood processing corporation. After retiring from operative responsibilities as president in 1977 and becoming the group chairman, Gustav Rosenlew established Mancon Oy as a 'hobby' in 1978. The new company's business idea largely derived from Gustav Rosenlew's experiences from a 13-week executive programme that he had completed in the early 1970s at the Harvard Business School. The programme's emphasis on entrepreneurial perspectives had been of stimulation value. (Hosia 1985: 80.)

While it had taken a talented central banker and a two-year mission at the World Bank in Washington to get venture capital *imported* to Finland in the mid-1960s, it took a wealthy individual and a case course at Harvard in the mid-197s before it was launched as a *business.* In retrospect, it took the entire economy's leap (first) to the liberation of financial market in the mid-1980s and (second) to the EU's single market in the mid-1990s, before the business could be *profitable* on the long term.

Although Mancon was not started unaware of the immaturity of the Finnish market for venture capitalism, the company's creative efforts to compensate for the shortcomings of the market failed and the company ended up in bankruptcy in 1989. [171]

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170 To put oneself in the right perspective, Finland at the time was very much controlled by powerful financial and industrial groupings which, according to Daems (1978: 7), were typical to European (reportedly Belgian) and Japanese capitalism in general.

171 "The name - which does not mean anything - the partners invented themselves. It did not occur to them that, reversed, Mancon is Con man, which is English and stands for a swindler." (Hosia 1985: 79-80.)

> "[We] understood early on that we could not earn our living from venture capital company activity in Finland. Mancon has ever since foundation engaged also in other areas, such as M&A brokerage" (Rosenlew 1985: 129).

What preceded the failure, among other things, was a change or expansion of the owner base, a conversion from individual *towards* institutional ownership, in 1982. What followed the expansion of ownership, in turn, was quite an extensive expansion of investment activity. Mancon's first years of operation, 1978-1982, were a period of modest and controlled growth of both the funds and the investee portfolio. The company had been founded with only FIM 100,000 as shareholders' equity. By the end of the period, Mancon's portfolio consisted of ca. 10 investee firms. During its first years of operation, Mancon failed to receive the Lex Sponsor status. According to the Ministry of Finance authority (interviewed in 1988), Mancon did not meet the central criteria of a stable and wide enough ownership base; it had, e.g., no banks among its shareholders. When Mancon's application for the Lex Sponsor status was finally approved in 1984, the company's owner-base included the Skopbank of Finland (hereafter SKOP).[172]

The coming of regional governmental venture capital companies (1980-1983)

Kehitysyhtiö, the original Finnish equivalent for *venture capitalist*, was early on associated as differently in Finland as could be expected from the conceptual outset. A *kehitysyhtiö* is a legal person who out of a good social conscience deals with poorly-performing businesses; much like compassionate industrialised countries deal with developing countries. In Finnish, *developing country* translates into *kehitysmaa*. The association can be seen culminating in the foundation of *Kehitysaluerahasto Oy* (e. the fund for *developing* regions), in 1971.[173]

Kehitysaluerahasto was founded by the government as part of its economic policy for the less developed rural areas to subsidise businesses and create opportunities by providing risk capital, unsecured loans, and management consulting. It was not considered to be a *kehitysyhtiö* itself, however, because it would not operate as an active equity investor. Instead, Kehitysaluerahasto established two regionally focused *kehitysyhtiö* daughters: Keraspo Oy for Eastern Finland in 1980, and Lakespo Oy for Northern Finland in 1982.

Following the example of Keraspo and Lakespo, the first municipality or county-held (region governmental) venture capital companies were established during 1982-1983, in Imatra, Jyväskylä, Kokkola, Posio, Pori, and Valkeakoski.

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172 It is possible that the Finnish government was aware of the SBA section 503 program, in 1983. The American programme worked through "local development companies (LDCs)" pursuing "to stimulate employment, private investment, and more business opportunities in areas where development companies are organised" (Purcell and Patrylick 1983). Whereas the American programme seems to have been significantly more regulated and bureaucratic than its Finnish counterpart, section 503 programme was not America's 'prime' engagement in venture capital like Lex Sponsor was for Finland

173 Kehitysaluerahasto Oy later changed its name into Kera Oy and, recently, into Finnvera Oy.

Hereby, cities and counties had entered the venture capitalist arena. After the launch of these pioneers of a kind, dozens of similar companies have become established by cities, counties, and regions; in fact most counties in Finland have an LTD structured company vehicle to which they refer as a *kehitysyhtiö* - or a close relative thereof.

Consequently, in 1983, the venture capital industry in Finland consisted of ten companies of which only one was private sector controlled.

6.2.2 *Corporate* rise and fall: Building on a publicly-held single LTD structure driven strategy logic

6.2.2.1 Fiscal scheme and trend-setting IPOs of leading companies drive the first industry boom (1984-1986)

As reported to the Finnish Ministry of Trade and Industry by Andersson (1982), the capital structure of the Finnish industry had severely deteriorated during the 1955-1980 period. The average indebtedness (debt to assets) had increased from 55% to 80%.[174] There was clearly reason for concern with regard to the development status of the entire capital market, not only the venture capital end of it. Andersson's (1982) report, titled "A study on investment companies as tools of industrial policy," had been commissioned by the government simultaneously with a report from Rosenlew and Oravainen (1982) titled "A study on venture capital (*kehitysyhtiö*) companies as tools of industrial policy." Whereas the former study examines, in essence, mutual fund type activity, the latter ponders more directly upon venture capitalism sparing, however, the phrase *venture capitalist* for a later introduction.

During 1984-1986 a significant expansion of private-sector venture capital activity was experienced. The boom was largely driven by Sponsor and Mancon, the industry pioneers. By the boom years, both had changed ownership - and strategy logic - and both were to become publicly-held firms. Both ended up *corporate* but, where Sponsor had started *governmental*, Mancon had an *individual* start.

Privatisation of Sponsor: Invisible changes in strategy logic

In its history since 1967 Sponsor has become 'privatised' twice. In 1983, the bank of Finland sold its 60% interest in the company turning it a private firm. Soon thereafter Sponsor got listed on the Helsinki Stock Exchange. The second privatisation took place in 1991, when KOP, having acquired the dominating majority in Sponsor via the stock market, delisted the publicly-held company turning it a private firm for a second time.

At the same time the first government commissioned venture capital report (Rosenlew and Oravainen 1982) was published, Virtanen (1982) completed a seminal study on venture capital - a report published by Sponsor

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174 Figures not corrected for inflation.

Oy. Whereas the former report could fairly be seen to have prepared the ground for Mancon's acceptability for the Lex Sponsor status, the latter report can be seen as a push for the field's general, and Sponsor's specific development. According to Virtanen (1982: 167-168), the ideal owners for a venture capital company are private investors, businessmen, and corporations. He also concludes that FIM 10-20 million is a minimum equity base for a venture capital company. He recommends that at least Sponsor's activity on a large-enough-scale be secured and that, should the need arise, its equity base be flexibly increased. At year end 1981, Sponsor's equity base was 14.8 million.

> "Due to its risky nature, venture capital activity is suitable only for such professional money managers who have the financial resources for risk-taking, and the ability to bear the consequences of a potential failure, and the possibility both to operate flexibly and to employ superior personnel. Hence the best way to create profitable venture capital activity is to enhance the risk-taking-ability of privately based enterprises. If a subsidised venture capital company is owned by financial institutions, none should be in a dominant position, in order to avoid the unjustified use of the venture capital company into company restructurings and risk taking. If, in turn, industrial corporations are the owners, also then should the domination of one party be prevented, in order to avoid potential conflicts of interest." (Virtanen 1982: 168; translation by the researcher.)

In 1983, the Bank of Finland sold its shares and Sponsor Oy shifted from governmental to corporate ownership. The founding owner had held its 60% of equity since the launch of the company, for 16 years. The Bank of Finland had not established Sponsor to achieve maximal financial returns and such were not driving the Bank's decision to exit its control position either.

> "It was no primary objective to realise big profits. Bank of Finland simply saw that it was no longer proper for it to only finance some given companies. It wanted to pull itself in the background and hence become neutral towards the industry. Sponsor had changed its operating principle and turned [from a special purpose company] into just another investment company."

In Sponsor's case, it can be concluded, change of strategy preceded change of ownership and, in a way, drove the change of owner. From the original founders' perspective, Sponsor started to permanently lose its special nature and status during governmental ownership already.

> "In the years to come, the basic idea changed. Sponsor became just another investment company, which neither held to the majority-acquisition nor the innovation-seeking principle. It was now primarily after ownership stakes in such SME sector companies that had sound profit projections... But, by the time, the company had changed nature, ... and ownership."

Once the change of ownership had taken place, a conscious redrafting of mission took place. What had started under the governmental ownership, became confirmed in full alignment with the interests of the new shareholders.

> "I am in the understanding that when [Sponsor] was a Bank of Finland company, it had social objectives, objectives related to R&D and SME sponsorship. When ownership changed, there was the clear change... that all charity elements would be

dropped, and [Sponsor] would operate as a normal business enterprise. Sponsor's objective was to be a good investment to its owners, i.e., to increase the value of its shareholders' investment. That was the operating principle and mission."

The biggest change following the change of ownership was visible in *fund-raising*. Whereas fund-raising had been non-existent under governmental ownership, it now became the *primary concern* of the company.

"Shareholders equity was not increased at any stage. It grew via [retained earnings] and, later, certain successful exits brought in something completely new. But the actual dynamic growth stage - measured by stock performance, emissions, and portfolio investing - started only later, after the change in ownership had taken place."

In its investment activity, the *corporate* Sponsor did not abandon all of its past principles and qualities, however. One well-remembered lesson related to the absence of the IPO avenue from among alternative exit routes. Instead of building its investees towards public quotation, Sponsor concentrated in building the value of its own shares - as the sum of the underlying portfolio.

"What perhaps dated back to the old Sponsor, was the idea of a 'well-meaning venture capital company'. The clear objective was to be a good, reliable, long-term owner, i.e., a good owner, in the investee or daughter companies. That is why the basic strategy, in the mid-1980s, was to make *permanent majority-investments* in *successful core businesses* [of given industries]; with a weight on every word, including permanent. This meant that Sponsor, first of all, does not enter in order to exit and, in that sense, already during early 1980s differentiated from classic venture capitalism, in which investments are understood to be temporary... [Sponsor] was afraid that if it sold [an investment] very swiftly and, on the top, to a party which the original [supplier] had disliked, the company's reputation would have deteriorated. At the time permanence was a good principle towards clients. The same it made the operation a lot stiffer so that, later, when the time was ripe for exit, then exit was impossible for image reasons"

In 1984, Sponsor was, among the first firms in the 1980's, listed in the Helsinki Stock Exchange. During the 1984-1985 period, the OTC market was created in Finland, and the financial market extensively liberalised. Throughout the changes, Sponsor remained focused at top quality investment targets.

"[Sponsor] defined its [investment strategy] so that it is no restructuring firm, but an acquirer of successful companies that rather pays an overprice for a very well-doing company than takes on for free a poorly-doing one."

Mancon approved for the Lex Sponsor status (1984)

Only after Sponsor itself was repositioned for competition following the 1983 privatisation and the 1984 listing on the Helsinki Stock Exchange, the Lex Sponsor status was granted to other companies.

To meet the Lex Sponsor requirements, Mancon raised more capital. The equity reached FIM 5.5 Million, after the entry of SKOP (the commercial bank), by 1982. In 1984, when Mancon's portfolio already exceeded 40 firms, it was finally granted the Lex Sponsor status.

The first industry boom

During 1984-1986, a total of 23 new venture capital firms were established, of which as many as 18 were non-governmental (see table 37). Of the 23 new firms, Lex Sponsor status was granted to six corporate and two governmental companies (Seppä and Näsi 1989). All applications for the status were accepted in 1985-1987, due to the liberalization of the Lex Sponsor requirements. Partial ownership held by a commercial bank was still required, however.

In 1987-1988, 15 new venture capital firms were started, of which six were *captive* corporate, seven independent corporate, and two were governmental. None of the 14 received the Lex Sponsor status. Table 37 illustrates the rise and decline of the *kehitysyhtiö* field, in 1967-1990, by owner-type in Finland.

TABLE 37 Industry formation under the *kehitysyhtiö* era by owner-type

year	govt firms	independ. corp. firms	captive corp. firms	entrepren. firms	firms total at year end
1967	1 (100%)	-	-	-	1 (100%)
1978	1 (50%)	-	-	1 (50%)	2 (100%)
1980	2 (67%)	-	-	1 (33%)	3 (100%)
1983	9 (90%)	-	-	1 (10 %)	10 (100%)
1986	14 (42%)	14 (42%)	2 (6%)	3 (9%)	33 (100%)
1988	16 (33%)	21 (44%)	8 (17%)	3 (6%)	48 (100%)
1990	17 (57%)	6 (20%)	4 (13%)	3 (10%)	30 (100%)

The companies of the *kehitysyhtiö* era sought to follow the example of Sponsor and Mancon, the industry pioneers. The image of the venture capitalist was, from the industry's beginning, very different in Finland than in America. In America the venture capitalists, 'by definition', had a face, whereas in Finland they were, as according to Lex Sponsor requirements, faceless institutions.[175]

The *social worker image* of the early years of venture capital caused twisted expectations on the industry companies. In this sense, the Lex Sponsor status was a double-edged sword, whereby the objective of fostering growth and creating new jobs was attached to the leading venture capital companies 'by definition'. The firms themselves emphasised their concern for this issue in their marketing and publicity. For example, non-controlling investment stakes in troubled businesses were often referred to favourably by the media

The industry's image was built on high hopes, and venture capital companies were cherished in the public eye in 1984-1986. In 1987, the contemporary media reported of 'changes in venture capital company strategies' and, since then, the public image of the industry deteriorated until a full collapse in 1989.

[175] According to a successful Finnish entrepreneur, *"the impossible was trying to match the world of a technocrat [institutional] venture capitalist to that of an independent, risk-taking entrepreneur."* (an interview conducted in 1988).

6.2.2.2 Towards the burial of a strategy logic (1987-1989)

In 1987, Lex Sponsor company *Oy Expaco Ab* was taken over by a rival due to its deep financial difficulties caused by its unsuccessful minority investment strategy. Sponsor announced, after the changes in the media perceptions of the industry, that it no longer was a *kehitysyhtiö*, but a *growth company* (kasvuyhtiö).

At the same time, with the first bad news regarding the finances of venture capital companies, news about their disliked change of strategy began to receive bigger headlines. Before that, venture capital companies had declared themselves as only interested in majority stakes in well-performing businesses - far from the classic venture capitalist investment criteria. Now, it appeared, some venture capital companies were working on hostile take-overs of undervalued publicly-held corporations. The sudden contrast between the early image of a 'social worker' and that of an emerging 'vulture capitalist' was overwhelming.

The take-over (1987-1989) and delisting of Sponsor

Partially for historic reasons, Sponsor's strategy was to *keep* its portfolio firms. As time went by, this could be seen as having worked a trap for the company.

> "When you fall in love with a company you think all the time that it is too early for an IPO, that it would go a bit too cheap. The other obstacle, that emerged during the late 1980s, concerned the fight between the banking spheres. When Sponsor slided into one sphere, the issue emerged that an IPO would move the investee outside the sphere. It was better to keep and build conglomerate."

For a few years after its conversion from governmental to corporate ownership the management was able to continue the management-driven tradition.

> "During 1984-1987 owners were very passive, i.e., the ownership was dispersed. Instead of the board of directors, the owners were represented in the supervisory board. Sponsor got a professional board of directors in which there were no direct agent of an owner or a financier. The board associated itself very strongly with Sponsor, the company, and the independence will came through very strongly, and Sponsor's best interest always surpassed the owners' interest."

KOPacquired the controlling majority in Sponsor via the public stock market. Sponsor had become "a sort-of a mature company."

> "The ownership was relatively dispersed - each party had its ten percent... When the growing of stakes, the trading, started - you a bit more here, we a bit more there - then also [the management of Sponsor] decided that whenever an owner made a move, they launched a defence operation. Take-overs and protecting measures where the theme of the day. Sponsor was apparently a respected firm and attractive target. Capital was no problem at any stage. When ownership changed [via trading]... it was again balanced via private placements - with the aim, of course, that the new shares would find their way to parties that were friendly with the management."

In the go-go years of Finnish managerial capitalism, when - in the absence of actual owners - hired managers practised empire-building, Sponsor became

targeted as a major piece in a puzzle to create a large Finnish financial group, Securus, that was supposed to merge KOP and Pohjola (a plan that eventually failed, as did both of the two companies mentioned).

> "Somewhere around late 1987 [the management] had the information than the KOP sphere has over 50% [of control], although it was nowhere visible. At that time the decision was internally made that this is a done deal, that principally the independence fight is over, since someone has over 50%. It started to show on certain operative dealings such as [transactions, cases]... where, for no sensible reason, there was a 'stonewall' ahead. The only reason why there was such a 'stonewall' ahead was that someone had over 50%... The [conglomerate] growth stage was history, IPOs [of investees], from Sponsor's perspective, were history. The stage came when everything was at a standstill. That was when the owners came to the board of directors... It was probably already in 1989 when they were visibly in, and in the fall of 1990 Sponsor was delisted from the Helsinki Stock Exchange. That was the final public closing of the book." [176]

Regarding the possibility, referred to earlier in this study, that the venture capitalist of a publicly-held venture capital firm may change non-voluntarily, via take-overs, Sponsor offers a schoolbook example. The quote below catches the essential:

> "It was probably looked at merely as a good business transaction... The owners had a clear idea that assets will be sold off... The driver were the problems of Securus, rather than to make Sponsor a better company... It was figured that Securus could be saved by Sponsor's cash flows... Sponsor became a clear target of a strip-off... Instead of seeking to control the Sponsor's portfolio businesses, [Sponsor's new owners] merely controlled what Sponsor was to do with its assets, i.e., does it sell. It was no longer driven by a venture capitalist's decision rationale, but by an owner's lack-of-money rationale."

Once the plan to build fortress Finland had fallen, KOP concentrated in keeping Sponsor as the group's captive venture capital firm.

> "Now [1993] Sponsor is KOP's venture capital company. The way we see it, Sponsor can operate successfully in this role in the future. Under no circumstances will it become a junkyard. We will not pour the bank's problems therein. Its portfolio investments must genuinely fulfil [Sponsor's] own business idea. It is also a kind of funnel to refine the companies and then perhaps sell them on... I am in the understanding that Sponsor has survived the recession extremely well. It never sank into red at any point. Now it is increasingly profitable."

The fall of Mancon (1989)

Mancon was listed in the Helsinki stock exchange in 1985. The next year its portfolio already consisted of ca. 100 companies. In 1987, Mancon's portfolio exceeded 160 firms and it had a total of FIM 36 million of equity capital. It now declared that it would, in the future, concentrate on majority investments. It was the last private-sector-capital based venture capital company to do so.

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[176] Coincidentally, by the time Sponsor (est. 1967) became delisted and fully acquired by KOP, it had come to follow a *somewhat* similar path than the legendary ARD; only 20 years later, and in Europe (ARD, est. 1946, was delisted and fully acquired by Textron in 1971).

For Mancon the change in strategy came too late, however, and it ended up in bankruptcy in 1989. According to an informed, senior observer Mancon had been - overall - less critical than Sponsor.

> "Sponsor was very critical in investee selection from the beginning, perhaps even too critical in the very beginning, so slow was the getting-started stage. The same carefulness was characteristic of Sponsor during later years, whereas, it seems, exactly such carefulness was missing from Mancon. It was just so aggressively growth-oriented that these other criteria played a second fiddle."

Partly due to disappointments in the investment patterns of the *kehitysyhtiö* era companies, the Ministry of Finance did not grant the Lex Sponsor status to any firms after 1987. Instead, a *venture capital* project was started at Sitra; in an effort to re-establish the reputation of the industry by fostering a new *venture capital* culture; resulting in an all new era in the industry development.

In a study by Taloustutkimus Oy, the corporate image of firms from 22 different industries was surveyed among the readers of Tekniikka & Talous, a business newspaper published by Oy Talentum Ab.[177] The overall rating of venture capital companies, on a scale of 4-10 (4 poor, 10 excellent) was 6.52; the average for all industries being 7.28. Factors that increased the *kehitysyhtiö* industry's average rating included: Professionalism of personnel (+14), alertness to developments (+6), and ability of management (+6). Factors that *decreased* the average included: Future prospects (-11), quality of products (-11), media visibility (-29), and company advertising (-41).[178] The results are like nails in the coffin of the *kehitysyhtiö* era. (Puttonen and Edlund 1991.)

It can be concluded that none of the venture capital firms established to utilise the single LTD structure remained successful for more than ten years under the same owner-type. As if there *had to be* a change in strategy logic every ten years - or more often.[179]

6.3 The second coming of venture capitalists: An industry restart

By the late 1980s it had become evident that Lex Sponsor and the *kehitysyhtiö* model did not resolve the early-stage financing needs of Finnish SMEs; no private *kehitysyhtiö* was active in financing high-tech start-up companies. The government had every reason to conclude that private capital primarily seeks

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177 The venture capital industry was addressed in the survey as the *kehitysyhtiö* industry.

178 The figures in parentheses indicate the relative 'pull' of each factor.

179 In their study on the performance of publicly-traded venture capital companies in Europe (comprising of 18 French, 11 British, 2 Dutch, 1 Belgian, and 1 Spanish company), Manigart, Joos and De Vos (1992) find that only 8 of 33 companies (less than ¼ of total sample) had, in 1977-1991, produced a return higher than market average. In an interview in Helsingin Sanomat (1990: June 26), Seppä points to the social *kehitysyhtiö* profile, the single LTD structure (pressure for stable financial performance on annual basis), and Lex Sponsor (incentive to generate dividend income from portfolio companies) as the drivers of the industry's dead-end in Finland.

maximal financial returns. If such are not available, private money will not work to complete the functioning of the economy. Instead of investing in technologically ambitious early stage prospects, the Lex Sponsor firms had chosen solid cash-flow generating businesses - even real estate targets - in order to maximise dividends and make the maximal use of their fiscal incentive at the expense of their 'official public promise'.[180]

Much of the pioneering work to get the industry restarted was conducted since 1987 by Sitra, the government entity established with Sponsor in 1967.

6.3.1 *Institutional* discovery of the LP fund structure (1989-1992)

Twenty years after a governmental Sponsor imported *kehitysyhtiö* activity to Finland, a programme emphasising the need for *riskisijoitusyhtiö* (e. risk investment company) activity was started at Sitra. This could be seen as an organised attempt to turn around or, better yet, restart the industry (so vastly had the *kehitysyhtiö* era damaged the industry image). In 1987-1989 several reports were published by Sitra on venture capital under brand new Finnish terminology. Following the early research, Sitra (as well as the Industrialisation Fund) set up an experimental limited-life LP fund structure of their own.

Under Sitra's leadership Suomen riskisijoitusyhdistys - Finnish Venturing Association (FVA), was established in 1990.[181] Only *riskisijoitusyhtiö* labelled companies (new groups as well as *kehitysyhtiö* 'converts'), no *kehitysyhtiö* labelled firms, were accepted for FVA's membership.

In 1990, an SME council report of the Ministry of Trade and Industry proposed measures for the development of the venture capital industry (Pk-yritystoiminan neuvottelukunta 1990). The report acknowledges (with reference to Sitra's research) the usefulness of the limited-life LP fund vehicle, but not the importance of management-owned structures (referred to, e.g., by Albach 1983) to venture capitalism. Instead, a limited-life LP fund was proposed to be established (at ca. $20 million) by the government as the sole funder and Kehitysaluerahasto as the venture capitalist. Consequently, *SFK Finance Oy* was established (by Kehitysaluerahasto) to manage *Start Fund of Kera*, the new governmental venture capital fund. At the same token, Sitra was separated from the control of the Bank of Finland as of 1991, when it was transferred under the supervision of the Finnish Parliament with a founding capitalisation of ca. $70 million. Sitra was also activated as a venture capital investor.

The company that led the industry's second coming, however, was a private sector firm: CapMan Capital Management Oy, a company established in 1988 and MBOed from corporate to entrepreneurial ownership in 1993.

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[180] This is not to blame the companies, however. The Finnish market was just no match with classic investment criteria due to underdeveloped enterprising culture (lack of world-winning-entrepreneur characters and public encouragement for such) and small isolated market (a Finnish-speaking 'island' in the 'armpit' of the USSR).

[181] Later renamed as *Suomen pääomasijoitusyhdistys - Finnish Venture Capital Association* (FVCA).

Shaping CapMan's early strategy logic

Liberation of the financial market and creation of the OTC market in 1985 pushed the Finnish framework for venture capitalism a leap forward. IPOs and new issues of stock by listed companies began souring and, by 1988, the flow of businesses interested in raising either equity or debt capital on the public market played a notable role as a new source of income to commercial banks.

KOP found an increasing number of corporate clients interested in its emission services. Many, however, lacked a *degree or two* of maturity. The bank soon identified a niche for a new type of independent corporate finance firm that would supply the bank with emission clients after a period of 'hand-holding'.[182] Programatic Venture Management Oy, the Finnish subsidiary of the Swedish Cap Programator Ab (a consultancy providing management solutions such as incorporation of management functions), which had served KOP for some time, acted as an important catalyst to get the new business started. The two approached Pohjola (Finland's biggest insurance company) with the idea.

Pohjola, given its standing as the country's leading institutional investor, was also frequently approached by corporate clients with requests for private equity finance. Pohjola saw that it could use a company that would screen and analyse private equity deals on its behalf, a company to which it could kindly direct private equity financing requests.

In 1988, the preparations led to the foundation of CapMan Capital Management Oy, the company that would later commercialise the limited-life LP fund structure in Finland. KOP subscribed for 40%, Pohjola for another 40%, and Programatic Venture Management Oy for 20% of CapMan's founding equity, all in all FIM 60,000. The company did not get operatively started before 1989, however. Once it did, immediately after initial success, the share capital was increased into FIM 2 million; subscribed to by the founders, *pro rata*.

KOP and Pohjola together held 80% of equity control in CapMan. KOP's initial plan was, however, not related to control. Once the business changed nature from advisory to investment, the sentiment changed.

> "Our intent was not even to keep the 40% but our idea was that we would have diluted ourselves by bringing in a couple of new owners. We would have gone down to 20% of CapMan's stock. We never actively decided that we would no longer seek for such outside owner. At first, we did not find logical candidates and then we started to feel that it might be quite good to have a bit stronger grasp of this thing."

CapMan was a joint venture of Finland's leading financial institutions and, hence, its management team was put together with thought. The founding managers of the company, Tuomo Raasio (the company's first employee), Ari

[182] Around this time, in 1988, KOP's takeover of Sponsor was well on its way. Because the founding of CapMan derived from a rationale different from venture capitalism, it was (also) engineered by different people within the bank.

Tolppanen (who joined a few months later), and Vesa Vanha-Honko (who joined soon thereafter), are all partners of the firm still today.

> "The idea was to put together a small group of individuals who can consult SMEs. They have SME experience... the team has a good combined experience. It is involved in a business in which a bank and an insurance company cannot be directly hand-in-hand with entrepreneurs, because their interest is a bit different. This is what we believed, and I think our thought has been proved right, that this is the way to create value-added in a company."

CapMan was, early on, built towards an independent image and the feel of a small firm. This was in everyone's interest. Understandably, the large institutional owners saw such a company to be a perfect vehicle to approach and deal with entrepreneurs, at arm's length, but yet close enough.

> "There was the hidden agenda that - in relation to the entrepreneur and CapMan's role - in many situations it was better that it was CapMan and that KOP and Pohjola did not show in the background. Absolutely. On the other hand, CapMan in a smart way used the names of its backup institutions in its marketing, because this increased their company's reliability. Apparently some value-added became created via this combination."

At first, CapMan was designed as a corporate finance related advisory firm with an emphasis on governance services, in monitoring resource allocation and guidance towards public quotation. Although arranging financing - on a client-to-client basis - for prospective companies was from early on CapMan's agenda, it did not start as a venture capital company. For a good candidate, there seemed to be financing available either from KOP or Pohjola, or from outside.

> "At first, our product was investment-potential analysis. We went around selling investment-potential analyses. We would look at a company from a neutral investor's perspective with an eye on its eventual public quotation and the measures to be taken to become a company attractive to the capital market. This was a quite straightforward business idea."

But the primary idea of Finland's leading bank and insurance company was not to earn from the sale of investment-potential analyses - a few millions, at best: The new activity was expected to yield them business, and much greater returns, indirectly.

> "Our capital market department had an interest therein. We wanted a clear division of labour with CapMan, that they would not enter the emission market. There's the line, and there'll be a huge cry if they try to cross it. When an investee firm is ready for the market, then it is KOP and its emission department that will take it public. That is were CapMan's work ends... On the other hand, we could not have taken [CapMan's] role; that we had moved backwards in the process and say: 'Here's an entrepreneur - let's take him by the hand'. That was not our task."

Early on, CapMan's message was different from that of the *kehitysyhtiö* era companies that had become associated with nursing of poorly-performing

enterprises - not the couching of the best prospects as superior performers as had been the case in America.

> "Yes, yes. This was the exact opposite. It was the dominant factor that [the investee] was an IPO prospect in a couple of years' time."

Management-driven change of strategy logic

Already in its first year of operation, 1989, CapMan changed strategy and prepared for the raising of a limited-life LP fund. Following a change to the worse in the climate of the capital market, CapMan started conversion into a venture capital company. The latter half of 1989 saw a slowing-down market, fall in stock prices, and a rise of financial conservatism. Arranging to have investment capital of its own was becoming an increasingly critical element for CapMan's future. The idea of raising a venture capital fund, however, came from the operative management not from the owners.

> "The notion that this activity would be much more credible, if we had capital of our own to invest, came from the management... There was the clear understanding that we need to have our own investment money, in order to perform more efficiently in the role we were established for."

Once CapMan had made the decision of pursuing to raise a limited-life LP fund vehicle, there was the question of who (besides 'allies') would invest, and why, in a fund managed by a company owned 80% by KOP and Pohjola, the cornerstones of the 'blue-and-white' financial sphere.

> "Both KOP and Pohjola surely saw this as a sensible, high-risk/high-return part in their investment strategy. But certainly they were also thinking about the extra business this would generate them. That is perfectly clear... But that must be the case also in America."

One difference between Finland and America was that, in Finland, the first fund raising in history was yet to begin and many structural, legal, and fiscal issues were yet to be dealt with. What came with the package, nevertheless, was the fact that a financial-sphere controlled venture capital company - and not a management-controlled one - was planning the fund raising.

> "It cannot be avoided, looking at it from two perspectives: First, what is the return on investment and, second, since usually the investee is also a Pohjola insurance client, it could be that a small investment in an investee firm will generate significant revenues to Pohjola via insurance sales, and that is a different story. This is not an issue to address with pure investment criteria. On the side, we consider the other clientship and look at the total return, what we can earn on the client in total. On such bases, poorer returns may be accepted with regard to some investments in order to secure the client and his insurance revenues; which is our main business, after all."

The management of CapMan carefully studied the Finnish fiscal and legal environment since there was very limited practical experience of the use of a separate fund vehicle. They received valuable sparring from the management of

the Industrialisation Fund which already earlier had set up a limited-life LP fund structure, Suomen Riskirahasto Ky I (e. Finnish Risk Fund LP I).[183]

During the late 1980s to early 1990s, under the leadership of Sitra, the Industrialisation Fund, and CapMan, a dominating local LP fund structure emerged, in which the venture capital company serving as the general partner of the LP fund in fact operates in the role of investment advisor proposing investments to an investor council (composed by representatives of the limited partners of the LP fund), the decisive organ of the fund. Such solution is quite understandable under circumstances where an institutional, more or less captive entity was to be the general partner of the fund. It would be a lot asked, if a captive venturing unit pursued to raise an LP fund from *outside* investors and retain total control as a general partner. It would be logical that the funders of such a fund would require control over investment decisions.

Before year end 1989, CapMan launched Finnventure Fund I Ky, with a targeted capitalisation at FIM 200 million. The timing of fund raising was not optimal due to falling stock prices, and the fund was ultimately closed at FIM 66 million. KOP and Pohjola invested FIM 20 million in the fund (each) as the lead/seed investors; other funders being BS Finance Oy, Tukkukauppojen Oy, Repola Oy, and Panostaja Oy.

> "There was a touch of idealism involved, to see how venture capital activity functions in Finland. Will it function? It must be remembered that this was quite venturesome under the circumstances in which Mancon had just ended up in bankruptcy. I remember, in our board of directors, many looked at this as a gone-by 20 million. But, then again, today such decision would never be made."

> "You could say that [the funder base] was largely comprised of the bank's clients. That is were the contacts came from. It is perfectly natural that discussions like these emerge with parties with whom one is already actively interacting in different financial issues. You can make propositions and capital can be raised. Furthermore, referring to Finland's small market, this is how things usually emerge here. At the first instance, there were no exact analyses and calculations, but more of gut feelings and relationships. That's how it happens."

One would expect that the role of CapMan's own board of directors had decreased as a consequence of setting up an investor council as the new vehicle's decisive body, but the management's experience was just the opposite.

> "No, it increased... It was interesting. Of course - CapMan was no longer a two million investment, but a seventy million boutique... It had become the guardian of a larger pool and, in my view, the board became more activa; and it was enlarged, too."

The funders, themselves, confirmed the management's sentiment. The board of CapMan now had an expanded role in their participation strategy.

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183 Interestingly, the Industrialisation Fund had had an important role also around the first coming of venture capitalists, when Sponsor was being launched. The 'prototype fund' of the Industrialisation Fund itself and the creation of CapMan's first fund marked the launch of venture capitalists' second coming in Finland.

"From Pohjola's perspective it was exactly the point that we could thereby influence on that the investments targeted investees that were close with Pohjola, but were also analysed clearly and carefully enough to make them also investment-wise sensible targets, and were also made sort of outside Pohjola's own organisation. Analysis and evaluation by CapMan gave it a stamp of neutrality, due to an objectively conducted review."

In terms of investment philosophy, CapMan paid close attention to the lessons from the *kehitysyhtiö* era and assumed the role of an active, determined owner.

"At a fairly early stage a conversation of the investor's monitoring role is needed. We had a lot of experience from the *kehitysyhtiö* era that almost all of them had to finally, often via trial and error, conclude that the only solution is majority ownership and a relatively tight grasp of operative management. Elements like these became also attached to [CapMan] as well... This means the kind of investment terms, that you [secure control] without an obvious majority when judged from the direct ownership stake acquired."

Many venture capital companies acknowledge funders as their clients. This was the case also with *CapMan's management* early on. However, whereas (in America) entrepreneurial venture capital firms establish such funds to serve *outside* funders, in this case the funders themselves had set up and controlled both the company and the fund. The funders' involvement in CapMan's board of directors could be seen as securing that their interests also became served.

"There was pretty much exactly this securing aspect involved. By being inside CapMan we of course saw all the time how [the deals] happened, because they derived therefrom. Selection of potential investments happened to a large extent therein, and the [investor council] was presented with such a chewed-up proposal that there no longer were any great differences in opinion. And it was also one sort of a securing mechanism."

Inside CapMan, *funders* were depicted as the company's clients. As their venture capital process was still far from exiting related concerns, *consumers* did not make the list just yet.

"With regard to the fund, only the *funder* - those six parties that put money into our business - is our client. Investee firms are raw material... Those who buy [our portfolio companies] are of course not our clients. Our task is to transfer the investees from a development stage to another, refine the firms, and realise value-added. And when you realise value-added, it is the funders and ourselves that benefit from it."

In summary, CapMan had been started as a 'self-financing' advisory service. Its institutional founders had been after indirect strategic gains (new banking and insurance clients and related income) *more* than the profits *directly* accruing from the consulting business. The founders' indirect interests *did not decrease* after CapMan raised its first fund. Over time, as had been the case with Sponsor ten years earlier, 'market gravity' pulled for change of ownership.

6.3.2 *Entrepreneurial* awakening: Reversing evolution

> "Changes in ownership identities through time, as when slaves are set free or when land use is unexpectedly rezoned, are situations in which it is difficult to believe that resource use will be unaffected" (Demsetz 1988: 16).

According to Alan Rappaport, after LBO transactions that convert structures of hired management to teams of owner-managers "you are no longer dealing with the same culture, the economic incentives are much more compelling; there is much higher energy level, a much greater devotion to efficiency and risk-taking." (Robert 1988: 112).

6.3.2.1 Trend-setting MBO of the industry-leader prepares ground for a second industry boom (1993-1996)

> "The original thought came clearly from the management... [Owners] had become, like owners easily become at some point, a brake-on-progress from their perspective. It came from management to Pohjola and we talked about it at the bank. We... thought – 'why not' – that in fact the division of labour is clearer when investors are only present in the fund and other business is taken care of by the company."

The MBO initiative of the management of CapMan was viewed positively by the institutional founders of the company. The institutions saw, however, the value of the company and did not make the management's conversion from hired managers to owner-managers too easy at all.

> "It is healthy what we did in the sense that now the management has the incentive to seek revenues also from outside the venture capital fund, which is a bit too easy [income]. We somewhat complicated the negotiation process by turning CapMan's management contract on the Finnventure Fund callable. The management was crying out loud. But we said that if we own both the management company and the fund, this is no issue, the contract between the two. But if we only own the fund then the contract naturally means us a lot. Practically, after a certain notice period, under certain circumstances, the fund can replace the management company... It will have an effect on their performance, that is for sure."

Nevertheless, in January 1993, the management of CapMan announced that they had bought 100% of shares in CapMan from KOP, Pohjola, and Cap Programator. Thereby, CapMan became the first entrepreneurial venture capital company utilising the LP fund structure in Finland. The management did not make much of a case out of it, however.

> "The beneficiary for dividends has changed. Nothing else has changed. We have our niche where we want to be... Our strategic objective is to get out of the advisory work and concentrate 100% on management work... We are working on a special purpose fund right now, and will start raising a second fund for the Finnish market in the summer. Which means that we shall end up with enough capital under management for management fees to cover all our expenses. That's it. As simple as that."

Perhaps the new shareholders (the management) were - on relative terms - more concerned for the direct profitability of CapMan than the previous shareholders (the large financial institutions) had been, however?

> "In that sense you can say that there was a difference."

Instead of three institutional shareholders, CapMan was now owned by five individual partners as the venture capitalist team. Ari Tolppanen (president), Tuomo Raasio, Vesa Vanha-Honko, Olli Liitola, and Peter Buch Lund now 'owned the FIM 70 million boutique'. As a question of life and death, CapMan's existence had - all of a sudden - more (relative) meaning to its shareholders.

> "We could say that the setting is more perfect from the perspective of [each of our funders] than before, when KOP and Pohjola were in a dual role. Not to mention that our possibilities of raising more money are completely different when we no longer are bonded to certain groupings. The more I have thought of it, the more it seems to make sense. And so it has been interpreted by the market as well"

> "[Our ex-owners] have landed more purely in the role of an institutional investor and now their IRR thinking is the only thinking they have. Earlier their thinking was coupled with some captive strategic interests."

> "[Americans] in fact reacted positively, which to us was an extremely important signal. The Finnish market has reacted very positively. We are the first independent group. And we have received clear calls, even propositions of investing with us. But our mission has not changed. Our status in the eye of the investor may have improved and thereby our possibilities to raise more money have increased."

The institutional founders understood the change as *liberating* with regard to the management's frame of action. The following quote is most insightful in this regard. It must have been rationing of this nature that - eventually - turned *also the government* into an MBO mode in privatising venture capital.[184]

> "It brings flexibility, livelihood, and result-orientation into the picture, which is quite needed. It is enough role for corporations to control the fund, in which they have invested, where the final investment decisions are made. It is different, if corporations have a strong grasp of the tool itself, then the investment decisions are, in fact, made already there. The fund's decisions are more nominal. It is a healthier division of labour. [The management] can pick from a wide selection of cases completely free of any bias or making sure that the candidates are the clients of the owners, free also abstractly. There was no obligation before, but I think such a tendency has dominated thinking to a large extent."

The previous owners realised and admitted the dynamics of the situation so that under KOP-Pohjola ownership, CapMan would have been seen as a captive firm by the market.

> "You couldn't expect that KOP and Pohjola, for example, would continuously increase their investment stakes there. It is a much healthier order that, ok, there is one fund in which there are KOP and Pohjola, but you can raise another fund with other colour of investors, and a third and a fourth one in the same way. It gives

[184] Mere privatisation is not enough (as a change factor) as pointed out by McDonald (1993).

> more freedom from the start. It just is so that when there are two large national institutions as owners, the result tends to be that there will be no one but they and their clients - others stay out. Now you can talk to everybody."

In terms of investment work, the only significant difference found related to exiting and, even there, merely to the choice of underwriter in a potential IPO situation. It would still have been difficult via a bank other than KOP.

6.3.2.2 A slow, *but sure,* awakening (1997-)

> "One type of company that caught our attention is the owner-run one. These companies drew our attention because they usually perform better than the large, international giants against which they compete. The reason is simple; they are better managed. In spite of the resources available to large companies, the training it gives to people, and the expertise it can hire, the fact remains that owner-run companies are better managed." (Robert 1988: 109).

In the experience of Robert (1988: 110), owner-manager CEOs are better strategists. They are concerned that their strategy is understood by everyone and they want their people involved in the strategy process for the sake of clarity, consensus, and commitment. One reason is that "[the owner-managers] are concerned about their legacy and perpetuating organisation after their departure. Building a successful organisation that can outlive them is a major objective. This is not always the case in large public organisations... Worrying about their legacy and having a well-articulated strategy is not a strength of the CEOs of publicly-owned corporations."

In their expert opinion to the Nordic Council of Ministers on how to improve the matching of investment capital and business ventures in the Nordic countries, FVC Institute and Tampere University of Technology (1994: 38) conclude that there is no matching problem but a "match-maker" problem, in the government-dominated Nordic venture capital arena. They end up proposing privatisation of the government structures (terminology of the excerpt below is revised to be consistent with the present study).[185]

> "What does this mean in practical terms? Governmental venture capital companies which today make direct investments in business ventures, should optimally and eventually become either (i) managed by entrepreneurial venture capitalists by way of buyouts or buy-ins, (ii) managed by independent corporate venture capitalists by way of issuing stock or selling shares to private sector investors, or (iii) assume the role of a funder of entrepreneurial venture capitalists."

In 1995, Finnish Industry Investment Ltd, a governmental fund of funds was established in Finland, in part, to spur entrepreneurial venture capitalism (on the European level, the European Investment Fund has been active in a much similar role for some time). In 1997, SFK Finance Oy, the government-owned general partner firm of (the governmental) Start Fund of Kera, was MBOed.

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[185] The said report also proposes to establish a governmental 'fund of funds' to spur pan-Nordic entrepreneurial venture capitalism to compensate for the lack of funder tradition of investing in entrepreneurial funds. The initiative did not lead to a pan-Nordic government vehicle, however.

Sponsor's entrepreneurial awakening

In the 1990s Sponsor regained its position as a market player. It became KOP's arm for producing high quality material for the stock market.

> "This is what Sponsor is doing. Now it has announced that it will bring Kaukomarkkinat and Teleste public, at some point. Sponsor operates in the same market and field with CapMan and others, but its difference with a venture capital fund is that it always acquires a majority."

In 1997, Sponsor Oy, a single LTD structure, was replaced by two new legal entities: Sponsor Capital Oy and Sponsor Fund I Ky. Sponsor Capital was established to continue Sponsor's 'venture capital career' under entrepreneurial ownership. Sponsor Oy changed its name into Merita Invest Oy and invested its main portfolio interests in the LP fund as the new vehicle's founding limited partner. Sponsor Capital was founded fully-owned by Sponsor Oy's previous management and the company succeeded in raising also fresh investment money into its first fund from outside funders.

From the perspective of year 2000, a significant change in funder behaviour has taken place. First of all, funders do not appoint their employees as governors of the venture capital company, but outside specialists whom they trust and appreciate. In Sponsor's case, the council is an important sparring partner, operating in a role that resembles a contributing board of directors. The members of the council are elected following a consensus rather than a vote-per-dollar principle. This results in a co-operative and informal rather than bureaucratic and formal interaction between the partners and representatives of funders.

Sponsor was operated as a conglomerate until 1997 in the sense that all new investments were considered against their effect on the group's overall profit per share performance. After the change of owners, mission, and structure (in 1997), new investments were looked at as *projects*.

> "While Sponsor earlier could be thought to have comprised of 'the management's own money', the limited-life fund structure made it more clearly comprise of 'other people's money' - sort-of 'one-trip money'. Potential conflicts of interest related to exiting became replaced by a strong obligation, as well as an incentive, to realise the investments made... Consequently, also investment decisions are now much more driven by future-projected than historical performance."

Also, by the late 1990s, the general attitude in Finland towards selling a company or inviting a venture capitalist as a shareholder had improved. It was no longer associated with the company's inability to survive on its own.

Sponsor has stuck with one of its founding investment principles throughout its 33-year history and all the changes of ownership, namely the majority acquisition principle. This also continues to differentiate Sponsor from classic venture capitalists in the sense that it buys and builds *business* driven, rather than *entrepreneur* driven cases.

Driven by a clear owner mentality and exit objective, Sponsor prefers maximal control of portfolio over maximal utilisation of the entrepreneurial engine. Being human 'engines', entrepreneurs include unpredictable elements that also *increase* investor risk. One interesting difference in the investment practice of venture capital companies relates to syndication. Classic venture capitalists are often referred to as keen to syndicate, whereas buyout investors are more of the 'lonely wolf' type. In part, this has to do with the controlling of the entrepreneur risk.

> "One concept of the minority investor to control that risk is to syndicate and thereby spread the risk. The majority investor controls the risk by being involved deep enough."

On the other hand, this difference may be due to the fact that some venture capital companies actually 'ride waves' of new technology and markets – as a sort of gambling *investors* – whereas others are more driven by participation as *owners* in selected investee firms. Evidence towards such a view could be sought for in the fund-raising pace of the two extremes. It could be assumed that the former raises funds more readily as new general economic opportunities rise, whereas the latter could be found raising funds more conservatively, as it (necessarily) makes less investments and exercises more control in each one of its investee firms. There is also another aspect to 'surfing on waves', as reminded by Donald Valentine, president of the Western Association of Venture Capitalists: "The only time to invest is when an industry is in transition. In times of radical change, big companies are very slow to react. That's how we beat them. If we compete equally with General Electric of IBM, we will always lose, so we compete unequally" (Mann 1986: 11).

Furthermore, this difference can be seen to have developed into a fundamental difference in strategy logic; in how the two types perceive their products and markets – the business they are actually in.

CapMan assumes decision making control of new fund vehicles (1998)

Looking back on the first four years of being entrepreneurial, the management of CapMan accounted that for a long time it had felt it justified and even preferable that the funders had the role of the ultimate decision maker. At first, the management understood it was inexperienced and, after all, the money was funders' money. In 1997, the management started to feel both *professionally* and *mentally* ready for increased responsibility.

In 1998, the change took place. CapMan raised its fifth *Finnventure* fund under a decision-making structure in which the investment and divestment decisions were to be made, *de facto*, by the fund's general partner, i.e., CapMan. The funders were left with a mere veto power. In cases where two thirds of funders disapprove of CapMan's decision, the decision is reversed. Herein, the funders would vote according to a vote-per-dollar principle.

Regarding investment track record, looking back from a year 2000 perspective, two main issues are seen above others as the keys to success inside CapMan, referred to as the *first wave* and the *second wave*. The first wave comprises of investments in basic growth-businesses closed on relatively favourable terms in 1994-1996, when Finland was getting herself out of a historic recession. The second wave comprises of visionary investments made in the IT sector at the verge of the boom therein, again, closed on relatively favourable terms - compared to prices of the present time - starting in 1997.

CapMan's management does not believe that the company's growth would have been possible, if it had not converted from corporate to entrepreneurial ownership in 1993. The ownership change enabled fund raising outside the KOP-Pohjola interest sphere, and it developed the company's culture to the direction that made it possible (for example) to venture early into the IT sector in 1997. But how far was a 'complete awakening' (transfer of decision control from funders to an entrepreneurial venture capitalist) in 1993, immediately following CapMan's MBO? A funder comment from the time captures some of the essential of the rocky road that lied ahead.

> "It is not necessarily that far away in the sense that we have gained some experience and know what kind of activity this is. But it is a sign of our small market that, after all, one still wants to be there lurking for what is happening, what is the direction, and what is done. We are still not ready for the pure direct-return principle, that if it yields 20% it's enough and we ask no questions... that we have given our power of attorney to conduct such business, and if they cannot do it we have the means to fire them or replace them."

Today, CapMan is more a *European* than a *Finnish* player. In 1999, the company raised a large European fund of funds that invests in regional venture capital funds outside Finland, marking a clear leap in the company's strategy logic. Under ownership by Finnish institutions with key strategic interests in the Finnish market, it would have been difficult for CapMan to develop driven by market opportunities.

Seeing the trend

In 1993, CapMan turned from (semi-captive) corporate to entrepreneurial and, by 1998, it had matured for the responsibility involved in investment decision making. In 1995, Finnish Industry Investment Ltd was established by the government as a Finnish fund of funds, in part to encourage entrepreneurial venture capitalism. In 1997, Sponsor Oy was restructured and (as a business) converted from captive corporate to entrepreneurial. The same year, SFK Finance Oy converted from governmental to entrepreneurial. Sitra, which by 1998 had (fully) acquired most of Finland's leading regional governmental venture capital firms, declared a program by which local companies will be converted entrepreneurial following certain development steps. Figure 41 summarises the changes in Sponsor's and CapMan's ownership since the companies were founded, suggesting a clear trend.

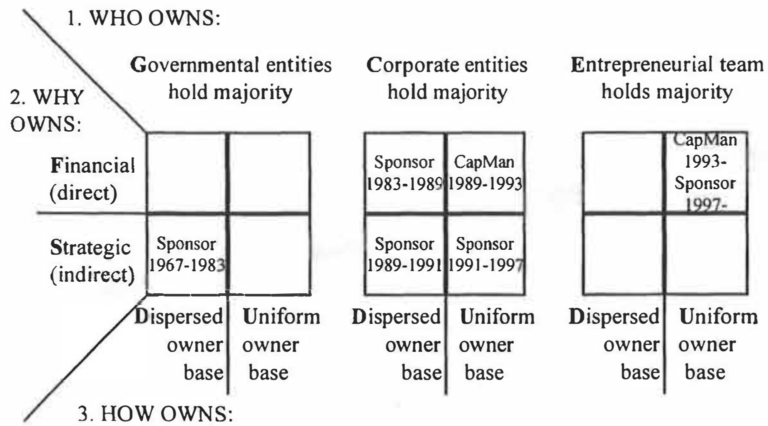

FIGURE 41 Changes of ownership in CapMan and Sponsor

Figure 42 presents an analysis of the ownership of the companies that responded to the industry surveys conducted in Finland in 1989, 1992, and 1997. The distribution of the respondent firms in the pigeonholes of ownership further confirms the trend of the field, in Finland, *down the tree*.

WHO OWNS:	WHY OWNS:	Survey 1989, 37 companies: Dispersed owner base	Survey 1989: Uniform owner base	Survey 1992, 29 companies: Dispersed owner base	Survey 1992: Uniform owner base	Survey 1997, 21 companies: Dispersed owner base	Survey 1997: Uniform owner base
private sector entities hold majority	Financial (direct)	11 (30%)	3 (8%)	3 (10%)	6 (21%)	⇓2 (10%)	⇑6 (29%)
	Strategic (indirect)	7 (19%)	1 (3%)	6 (21%)	1 (3%)	⇓1 (5%)	0 (0%)
public sector entities hold majority	Financial (direct)	0 (0%)	0 (0%)	0 (0%)	1 (3%)	↑2 (10%)	↑3 (14%)
	Strategic (indirect)	7 (19%)	8 (22%)	4 (14%)	8 (28%)	↓2 (10%)	5 (24%)

FIGURE 42 Transformation of the venture capitalist community in Finland

For the reverse evolution to complete in Finland, entrepreneurial venture capital companies need to push their funders from decision making, *ex ante*, to monitoring, *ex post*, as did CapMan in 1998. Traditionally, in America, the funders of a venture capital company make limited partner investments in LP funds to participate in something they *choose not* to do directly. Just as the investor in a mutual fund, the funder is buying into the fund's general partner's expertise. If, in either case, the investor thought he was a better expert than the professionals, he should invest directly. One has to let go of either the decision making control or the professional player, one or the other, on the long run.

As insightfully pointed at by an interviewee, *change* - even of market forces - fundamentally boils down to having the right individuals at the right time in the right place; be it small Finland or the global village.

> "What influences the emergence of big things is with whom one happens to discuss. In such a small country it is personal relationships and meetings. I believe there were relationships like this behind the founding of Sponsor, that someone presented the idea and that it was jointly developed further, looked at, and realised that this could become something. So it largely depends on with whom one happens to discuss about a given thing."

6.4 A looming third coming: Seeing through the trend

In company life cycle based thinking, businesses created by individual entrepreneurs are expected - if the business grows profitably - to gradually open their companies' ownership to outside investors. And the best ones are expected to eventually choose to become publicly-held via IPOs.

In venture capitalism, besides for single LTD structures, a similar avenue is open also for companies utilising the LP fund structure.[186] The largest such entrepreneurial firms already have tens of shareholder-employees. The senior partners of such firms, holding perhaps 20% each, and other partners, holding (at most) perhaps half of that, are increasingly tempted to floating a corner of their company stock. The sale of 25% of existing shares to outside shareholders - to enable public quotation - would mean a personal dilution from 20% to 15% for the seniors and from 10% to 7.5% for the juniors. Such a dilution could be an acceptable trade-off for a partial exit and an established exit avenue. In fact, why would venture capitalists not *pursue* floating; isn't this exactly what they preach for their portfolio companies to do? One reason might be - compressed in a word - control. Similar reluctance to share control efficiently prevents maximum growth of many SMEs. Like those reluctant entrepreneurs, many venture capitalists do not want to share control of their companies with outside investors; at least as long as they *do not own the control.*

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[186] The 'gravity' pulling *single LTD structures* towards public quotation has been witnessed both in America (e.g., the BDCs experiment reported by Bruno 1986) and Europe (e.g., the *kehitysyhtiö* experiment in Finland, reported herein).. 3i plc, a large UK firm, makes a good example of a publicly-held venture capital company utilising the LP fund structure.

In the light of empirical evidence to-date, venture capital is not a business for public quotation: A contradiction in terms, says Bruno (1986).[187] In most *growth industries*, entrepreneurs are expected to do everything to get their firms public. But just because venture capitalists are the biggest supporters of the going-public process, their business is not automatically suited for public ownership. A public firm is immediately faced with disclosure obligations and outside governance. Moreover, as noted by Roberts (1987), transition from entrepreneurial to professional management requires more than a mere change of structures and systems: It requires change in the *individual entrepreneurs' behaviour* and *delegation of responsibility to a layer of middle managers*, and the introduction of formal control mechanisms.[188] On the top, there is the threat of hostile entries: To some people, everything has a price. A venture capital firm gone public is, at the end of the day, a 'predator-turned-prey'. Controlling *control* is of highest attraction value in the market for corporate control.

In Finland, venture capital was started as *governmental activity*. In the next stage, a *publicly-held* single LTD structure gained market domination. After bankruptcies and take-overs of such firms, *closely-held* firms utilising the LP fund structure were found better suited for the job. Presently, the industry is in a transition from *institutional* to *entrepreneurial* ownership (via, e.g., MBOs). Recently, *even the control to investment decisions* has started to transfer from funders to entrepreneurial teams and, hence, the venture capitalists' *climb down the tree* to reach completion. During the industry evolution, significant changes have taken place in the Finnish market environment (see table 38 for a summary of the developments including 'steps' of the researcher's process).

Looking *through the trend* (taking the *venture capital spiral* view), a temptation to *climb back up the tree*, from entrepreneurial towards (again) increasingly institutional ownership via *public quotation* of venture capital companies - a third coming of venture capitalists - is looming in the horizon. Weeks before this report when to print, CapMan announced a reorganisation scheme (involving a merger with another company), according to which it will be listed (once through with the merger) on the Helsinki Stock Exchange in April 2001. CapMan's present shareholders are envisioned to hold 68.5% of equity and 84.5% of votes after the merger, *before* the public flotation.

> "CapMan's objective is to increase the transparency of venture capitalism, enable the participation of smaller institutions and private individuals in the return potential of this investment class, and to strengthen its own position as one of the leading venture capital firms of Northern Europe. The public quotation enables strong business development also via acquisitions... Once we have become publicly listed, investors will have the opportunity to participate in international management of venture capital funds via CapMan's stock. We do not invest our own funds in the portfolio companies, but funds that belong to our venture capital funds. In these funds, mainly institutional investors have invested in. CapMan's revenues accrue from management fees from the venture capital funds and carried interests." Ari Tolppanen (CapMan's press release, April 19, 2000).

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[187] 3i plc makes also a good example of an exception to this rule.

[188] All changes that significantly remould a venture capitalist's foundation of strategy logic: 'The ship the adventurer sails on unknown waters in search of new worlds'.

TABLE 38 Developments of the venture capital industry, the general environment, and the researcher's process during 1967-2000

PERIOD	Key developments of the venture capital industry	Major changes in the environment	'Steps' of the researcher
1967-1977 (0→1 firm)	Governmental *Sponsor established* (1967) as Finland's first *kehitysyhtiö*, along with national R&D fund Sitra	Finland joins OECD (1968); *'détente' moves in Europe (1970)*; oil crisis	('from 2 to 12-year-old')
1978-1983 (1→10 firms)	Private capital based *Mancon launched* 'against odds' (1978) 8 regional governmental companies established (1980-1983)	Lex Sponsor (1978), status withheld from other firms; *regulation prevails*	('from 13 to 18-year-old')
1984-1986 (10→33 firms)	*Sponsor and Mancon turn publicly-held corporate* firms in trend-setting IPOs (1984-1985), drive a private-sector venture capital boom: 2 entrepreneurial, 16 corporate, 5 governmental companies get started	*Liberalisation of* Lex Sponsor (1984) and *the capital market* (1985); first 'winds of change' (Gorbatchev gains power in the USSR 1985)	(industry apprenticeship programme begins, at age 21, at Panostaja, est. 1984, a private *kehitysyhtiö*, in 1986)
1987-1988 (33→48 firms)	*Lex Sponsor experiment fails expectations* (after a total of 10 approvals), preparation for 'gear shift' commences at Sitra; 13 corporate, 2 governmental *kehitysyhtiö* type companies established, nevertheless	Lex Sponsor halted (1988), *markka* strengthens, *bull market*, foreign lending increases, internationalisation of industrial firms via M&A measures	*Research project begins* (1987), *the 1st industry survey mailed* (1988) (industry apprenticeship programme continues in Finland)
1989-1992 (48→39 firms)	*Mancon bankrupt, Sponsor taken-over* (1989) and de-listed; ghosts of the *kehitysyhtiö* era (1967-1989) shaken-off with new terminology by Sitra, FVA; CapMan leads the industry's second coming by raising the *market's first LP fund*	*Markka reaches peak value*, USSR collapses, markka *loses 1/3 of value;* economy falls from all-time-high *deep into a historic recession*	*Research based in America* (1990-1991), *the 2nd survey* (1992) (appointed president of FVC at Panostaja in 1991)
1993-1996 (39→30 firms)	*CapMan turns entrepreneurial* in a trend-setting MBO (1993); a governmental fund-of-funds established (1995) to spur entrepreneur-driven venture capital activity	*Finland joins the EU*, declares 'the decade of entrepreneurship' (1995); towards recovery from recession	*The 1st case interviews* (1993) (partner of FVC, 1993-1996, from MBO to dissolution)
1997-2000 (30→40 firms)	*Sponsor and SFK Finance turn entrepreneurial* in MBOs (1997), first 'big time IPO' exits, Sitra acquires regional companies and commits to a privatisation scheme (1998), Finnish companies achieve top average return within EU	*IT sector boom*, Nokia Europe's most valuable company; Finland's EU-presidency (1999); first classic creations of 'start-up-to-IPO' wealth	*The 3rd industry survey* (1997), *the 2nd and 3rd case interviews* (1997 and 2000) (member of JYU faculty 1997-1999)

7 DISCUSSION AND CONCLUSIONS

7.1 Strategy logic of the venture capitalist: Past and present

> "The investors and key players in a new venture define success in different ways from a variety of viewpoints. Worthy goals for judging success are not inherent, but rather are individual to the viewpoint of each of the key players, the entrepreneur, inventor, venture capitalist, and executives of established companies. Of these players, individuals who expect success solely on the basis of tradition, science, logic, and rationale have difficulty in the venture management business, in new ventures... Venture management is not a science but a practical art. The venture capitalist studies economic trends and the business plan of the entrepreneur/ inventor and, finally, bets on his judgement of the *people* involved in the new venture." (Shames, 1974: Preface.)

The mission of this study was, at its broadest, to make sense of venture capital as a *business* phenomenon, as *someone's* business. It has become established that there are *several angles* to the phenomenon: It can be approached as *finance* for private businesses; as a *financial instrument*, an alternative investment vehicle available for sophisticated investors; as a *strategy tool* for corporate venturing; or as a *financing system*, without the functioning of which a modern economy cannot remain competitive – all 'music' to the ears of the *venture capitalist* – to whom it is a *business*.

From the outset, venture capital process, the visible frame of the phenomenon, leaves little room for speculation as to *what* the business is. Firms engaged in *fund-raising*, *entering*, *value-adding*, and *exiting* seem to be driven by a the world's most straightforward (classic) strategy logic: Creatively *finance* a clever idea to *purchase* unique raw material, *refine* it into a trendy product, and *sell* to the highest bidder. In reality, however, venture capital is a schoolbook example of a phenomenon for which theory and practice do not meet. The venture capital company, simultaneously a holy grail and a Pandora's box of the integrating world economy, is a vehicle actively used by its owners to fulfil missions so different from each other, and so fundamentally different from each other, that altogether different businesses can be identified within.

According to the central thesis of this dissertation, each venture capital firm serves a special mission crafted by its controlling owner, the venture capitalist. Assuming outright that they all share one and the same agenda, will result in unrealistic stakeholder expectations and, eventually, in disappointed investors, entrepreneurs, and governments. This, in turn, seriously hurts the venture capital mechanism in an economy, and dramatically decreases the potential of the venture capitalist to contribute to the efficiency and competitiveness of his country. In other words, the venture capital medicine is not an every-day pill of vitamin - but more like a strong drug: To be dispensed on prescription only, preferably under the *right* clinical conditions, and - to be optimally productive - a vaccine injected by a *rightfully* qualified doctor.

It is the conclusion of this study that the field should not be segmented along the lines of whether they invest in high-technology start-ups or mature-business buyouts; the classic distinction; but based on the role (demand) in economy that they actually serve. And governments should pay more attention to *why* various venture capital firms exist, than to *how* they exist.[189] The questions of who own venture capital companies; why own; and how own; are important to address for the *decision makers* to decide (for the future) who *should* own them, why, and how. Let the following quote from Demsetz (1988) lead our dive deeper into the topic.

> "In the Coasian world of fully developed rights and zero transaction costs, the identity of owners has no resource allocation consequences; in a world of changing and evolving [ownership] rights, in which information and transaction costs cannot be zero, the identity of owners, the content of the bundle of ownership rights, and the structure of ownership all have consequences. This is why some bundles of rights are more appropriate to one set of underlying conditions than to another." Demsetz 1988: 20.

7.1.1 Who, why, how; where and when?

After the collapse of communism, potential benefits to the economy from venture capital activity are recognised world-over. Thanks to the media and the communication age, the venture capital process - classically defined as hands-on equity investments in entrepreneurial, early-stage, high-technology based businesses - has earned public attention on a global basis. An increasing number of individuals, corporations, and governments from an increasing number of nations, have gained experience from unique applications of the venture capital concept. In the process, venture capitalism has outgrown its classic definition. In today's world, venture capital firms are founded on a variety of platforms, engage in a wide spectrum of investment activity, and serve a multitude of purposes and objectives.

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[189] All companies *manufacturing shoes* are in the *shoe business* - regardless of whether they produce high-heal design shoes for women or heavy working boots for lumberjacks. Also many firms that perform related functions, such as *shoe stores*, can be defined being in the shoe business. However, should there be evidence that shoes manufactured *in a certain way* would turn their wearer a better person, the government would have an incentive to stimulate the *way* rather than a *type of shoe*, or even the *shoe store*.

The economic implications of successful venture capital investing are known to most politicians and government officials. The activity of governments, worldwide, in stimulating venture capital investing makes them the fifth stakeholder of the phenomenon. From the governmental perspective - from the perspective of the society at large - it is natural to grasp at the promise of venture capital investing - to sponsor and support its mechanisms. Consequently, there is no significant political group that would completely ignore the status of the venture capital industry. However, there are certain, strongly political implications of successful venture capital investing that are not as often addressed as the above.

At its best, venture capital works economic *revolutions*. It is revolutionary against the establishment (the 'old wealth' and power structures) in that it challenges established companies in competition and invites the best professional managers to leave their executive positions with the 'old wealth' in order to become entrepreneurs, and to create new wealth (their own), instead. Venture capital is also revolutionary against the socialist stand, in that it challenges the 'averaging of people' as a social goal. Successful venture capital investments create new wealth, appraise superior performance, and foster 'hard values' (such as 'winner-picking' and wealth in general) as society ideals. On the other hand, venture capital does not work, if politicians are not committed to well-functioning market mechanisms and reasonable taxation.

A classic venture capitalist is like a farmer whose success depends upon many things beyond his own control. He is smart to select the area, the land, well before getting started. If he wants to grow apple trees he should choose the most suitable spot for such purpose. If, on the other hand, he is stuck with certain type of land he should carefully study what he should be growing there. The two do not always match. Nevertheless, he should prepare the grounds well, acquire the best available seeds, and plant them in the right way at the right time, i.e., at the right season. He should nurture the plants carefully and hope, yes hope, that the weather *enables* (not prevents) plant growth and, at the end of the day, the only thing that matters in farming: Harvesting.[190]

In modern reality, however, venture capitalists have diverged from the classic idealism of the likes of General Doriot. The farmers of today - for what we can tell - are engaged in *technically* the same process but are, underneath, driven by vastly differing motivations. Continuing the classic anecdote, it is more often a *combine* than a *man* that we can see on the field: A machine with no trace of a face. In this study, venture capitalists have become classified either as individual or institutional. The individuals fall further into either private or entrepreneurial venture capitalists and the institutionals into either corporate or governmental ones. The corporates are classified as either captive of independent and the governmentals as either national or regional.

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190 A classic analogy (Byers 1983), utilised also by an investee-case entrepreneur of Virtanen (1986: 178, 218) to whom *venture capital* was like the *fertiliser* with a price tag on it and he himself was the farmer: A perfect closing for a thesis written from the entrepreneur's perspective and also one that underlines - with the mouth of an entrepreneur - that the *right* amount of the *right* fertiliser, not the maximum amount, is what best does the trick.

The missions of venture capitalists differ. In this study, a great division between direct financial and indirect strategic missions has been established. This rough division is built-in in the owner-types listed above: Individual venture capitalists being (entrepreneurials in particular), more likely than the other types, after direct financial gains via the venture capital company. Private venture capitalists (business angels) have not been included in this study, but it is deemed possible that even indirect 'strategic' (general humane) interests are strongly attached to operations of a large proportion of them (such as was the case apparently with Jay Whitney). Independent corporate venture capitalists are after direct financial gains, but least in control of their missions (due to their typically very dispersed owner-base). Captive corporate as well as the governmental venture capitalists are, by definition, driven more by indirect strategic interests than any other type.

We have concluded that venture capitalists utilise either a single LTD structure or the LP fund structure. Clear tendencies have also been established as to which structure each venture capitalist is likely to choose; that financial-gain-driven venture capitalists utilising a single LTD structure are tempted to seek for public quotation; and that entrepreneurial such firms will have difficulties holding onto their control position as the venture capital company goes through several issues of stock and, hence, dilution of the founders' ownership. In terms of governance of venture capital companies, the width of owner-base has been acknowledged as a key factor. Since Albach (1983), it has been acknowledged that closely-held legal structures are preferable, in order to ensure the dynamic functioning of the venture capital 'mechanism'. With few exceptions to the rule, it has become established that a publicly-held venture capital company is a contradiction in terms (Bruno 1986).

Besides the differences related to who owns the venture capital companies, why owns, and how owns, it has become established that the prevailing variety of the above seem to vary as a function of 'time and place'. The *time* element refers to the fact that venture capitalism has transformed, as an industry, quite significantly across time and, interestingly so, sometimes to the opposite direction depending on the place. The *place* element refers to the fact that venture capitalism roots differently in different cultural and economic conditions. As vividly illustrated by case Sponsor, changes in ownership may *factually* change strategy (what is produced, to whom, and how) so vastly that the company's entire concept for business - its strategy logic - changes. In fact, a venture capital company's *business* may change without major *visible* consequences: It may continue to follow an identical investment criteria and principles, regardless of a changed rationale behind.

This research has yielded the proposition that by its underlying force venture capital is not only a finance phenomenon but, by and large, *an ownership phenomenon*, of close kin to entrepreneurship. Venture capitalists do *finance* businesses - it is not wrong to use this word - but they are *more* than

mere investors or financiers. This is not to say that investors and financiers would be less valuable operators, however. They are just different.[191]

In the perspective of this study, venture capitalism stands for moving and shaking old structures, challenging the existing technologies, systems, and ways of doing things. In this picture, the venture capitalists are, at best, the *guardian angels* of market economy on a mission to revolutionise industries and sectors of economy, forcing even the biggest of enterprises remain innovative and dynamic and entrepreneurial. [192] Many believe there are both black and white angels, however, and because man *is* mortal, there *are* ethical concerns related to such an extensive concentration of power on individual hands. It is to be noted that the power of the new financial capitalists is predominantly based on *contractual* empowerment, not personal wealth generated via building a business, as has been the case with the *industrial capitalists* of the past.

In the experience of Shames (1974: Preface), a successful business is primarily *people effectively communicating* with each other: "Without the rubbing, cross-fertilisation, real communication, and, on occasion, outright battling between entrepreneurs, venture capitalists, and inventors, and the fruits thereof, a venture manager would not become an increasingly better decision maker; a venture management company would not survive." Says Adler (1983): "Perhaps this is a contradiction of the theory of the great leader, but it may be that there is no such person. Generally speaking, it is *interaction* that produces good management decisions... My observation is that people who are good managers take advantage of each other by interacting as much as possible."

The discussion by Adler (1983) – 'the entrepreneur venture capitalist' – on what every venture capitalist looks for in an entrepreneur yields an outline on what every funder *should* look for in a venture capitalist. As Adler says: "Venture capital business is one of persistence;" every venture capital deal comes with unexpected problems, "daily, weekly, or monthly." Qualities that, in the experience of a successful venture capitalist, help an investee manager; should (perhaps) be applied to venture capitalists themselves.

> "In a sense, every venture capitalist is looking for the man with excellent management experience and past profit and loss responsibility who is greedy, hungry, and yet honest and sincere. He must have the intellectual integrity to admit his mistakes and to recognise and reward other people's talents. This man must be technically qualified to do the job, but must not be so immersed in the technology that he loses sight of the need to build a profitable business rather than a bunch of fancy products. He must be a man of ego. If he does not have a very large ego, he is not going to view the obstacles with sufficient confidence. Yet if he is too egocentric and one-sided, he will make some serious, dumb decisions because he refuses to take input from others. The man must be tough enough to make very hard decisions if the venture is to survive, and that means firing his best friend if necessary. Yet he must be smart and mature enough so that this toughness is tempered and so that the people he needs around him will not leave because his attitudes irritate them."

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[191] This point is further elaborated upon in chapter 7.3.

[192] Monopoly, much like socialism, suffocates innovation and entrepreneurship. The same applies to oligopoly where price cartels and unnatural barriers of entry can be agreed upon.

Judging from the effort behind this study, the *secret* of dynamic venture capitalism (*the whole world is after*) is as 'simple' as it is for enterprising in general, proven on a grand scale historically, and compressible in one word: *Entrepreneurship.* Wilson (1986: 215-216) closes his insightful exploration into the world of venture capitalists by noting how entrepreneurship has been widely acknowledged as the American industries' edge over their Japanese and European rivals. "Perhaps most worrisome of all," concludes Wilson, "Europe and Japan finally have awakened to the power of entrepreneurship and are taking serious steps to make it work for them." He could not imagine to which extent his words were right, at least for Europe. In the view of this study, the distinction for America's excellence over Europe (and Japan) in venture capital is in the *quality of capitalists,* rather than the *quantity of capital.* A concluding thesis of this European study, rephrasing a Japanese economist, reads: [193]

> "The *entrepreneurial venture capital firms* are the great advantage you (Americans) have *had.*"

7.1.2 The strategy logic window; what, how, and to whom?

It was an important objective of this study to contribute to strategising both *inside* and *outside* the venture capital company. Concretely this has shown in an effort to construct a theoretical framework that also has immediate practical application value. The final window on venture capitalist strategy logic is opened in this chapter. It is aimed at aiding venture capitalists design organisations, plan goals for performance, and make better-educated choices regarding product-market strategies (for the long term). Awareness and grasp of strategy logic enables a venture capital company position itself to survive and prosper within a constantly changing environment.

Post-war America represented a vibrant economy, boasting with green-field infrastructure projects, a world of *construction* (versus *reconstruction* in Europe). Large companies were mainly faced with the challenge of constantly increasing their production capacity. Start-ups based on new innovations to improve production efficiency became the natural first targets of venture capitalist attention. The post *cold-war* America was a much different environment with saturated markets, completed infrastructure, and inefficient diversified conglomerates severely threatened by aggressive foreign competitors (which had emerged much thanks to America's post-war contributions in rebuilding their economies). Venture capitalist attention became differently directed now that the challenge was largely to restructure and refocus, 'cut to the bare essentials', in order to simply survive in the increasingly competitive integrating world economy. During the 1980s, LBOs were invented as a cure and solution by which a publicly-held company could be delisted, 'operated', and re-listed as a whole or in parts.

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193 See the opening quote of chapter 1.1.

The legendary early venture capital investment successes created 'instant' corporate giants, new jobs and exports, entirely new industries - whole new competitive advantages of nations. Understandably, such individual successes have had a strong influence on the key characteristics to define and perceive what *venture capital* is. Consequently, LBOs have not been readily accepted within the sphere of venture capital concept, regardless of the fact that venture capital companies increasingly engage in such activity. Some of the reasons may be *political*; LBOs have been promoted by some authorities as shareholders' counter revolution, a response to the managerial revolution (to opponents, LBOs are an 'empire striking back'). Some of the reasons may be related to *change*, resistance to accept change. Other reasons reflect the magnitude of the interests of certain stakeholder groups, such as entrepreneurs and governments, to invest in a certain type of companies; the young, small, extremely *risky* ones. Venture capitalists are readily accepted as owners and governors of *small enterprises* but when they knock on the doors to govern and control *large corporations*, it may be felt as if they ignored the long line of stakeholders already outside the doors waiting to get in.

Mintzberg's (1989: 306) conceptual horseshoe on the desires around the large corporation - ranging from *nationalisation* to *restoration* (to owner-control) - is relevant also in the venture capital company setting. Though venture capital companies are one of the *smallest* organisations in business, they are (paradoxically) the concentration of some of the *largest* economic power; as vehicles that *can* restore owner-control even in the largest of corporations.

Sahlman (1990) made the pioneering conclusion that a venture capital firm performs economic functions similar to those of a leveraged buyout fund; both raise capital to invest in individual projects: "In the venture capital example, the projects tend to be early-stage ventures: In the leveraged buyout example, the projects are more mature businesses with substantial debt capacity." Due to historic and deeply rooted conceptual reasons, it is understandably difficult from a traditional American perspective to acknowledge 'players carrying a different label' (e.g., buyout specialists) as venture capitalists. In this study, the *venture capitalists* were discovered *also* within the sphere of the subject phenomenon (originally depicted as a local Finnish *kehitysyhtiö* phenomenon). Later still, it was hence easy to acknowledge *buyout specialists* as part of the same phenomenon as well. This, to some extent, also proves the points of earlier research of the *value of different backgrounds* and 'frames of reference' of the students of the field to insight and progress.

This study has markedly emphasised the importance of the entire venture capital process versus attention at a given stage. The quantity of made investments and their distribution across the company life cycles and industries are interesting issues to address, *per se*, but make only a tip of an iceberg - of a complex whole that needs to be considered before making judgements on whether venture capital investments in a given economy are too few, made in too large companies, or in the wrong industries. In the words of Klaasen and Allen (1980: 23-25), the wisdom to what extent a greater supply of venture

capital can aid the growth of a local economy "may lie in exactly how venture capital is viewed."

Venture capital is typically approached as a process - depicted as dynamic rather than static phenomenon - where distinct strategic issues (stages) are confronted one after another, over time, with regard to each individual investment. It has become noted, however, that successful exiting often leads to increased investor demand for additional fund-raising - for ever bigger fund vehicles - turning the proper illustration of the venture capital process from a stairway into *a spiral*. Depicting the venture capital process as a *spiral* extends perspective and brings the development stage of the *venture capital company* into the picture. This view also sponsors the insight that *individual venture capital investments* are no isolated incidents but outcomes of a *continuum of investing* and a *corporate evolution* process. In figure 43 the depiction of the venture capitalist strategy logic framework is 'twisted' to emphasise the spiral view to the venture capital process.

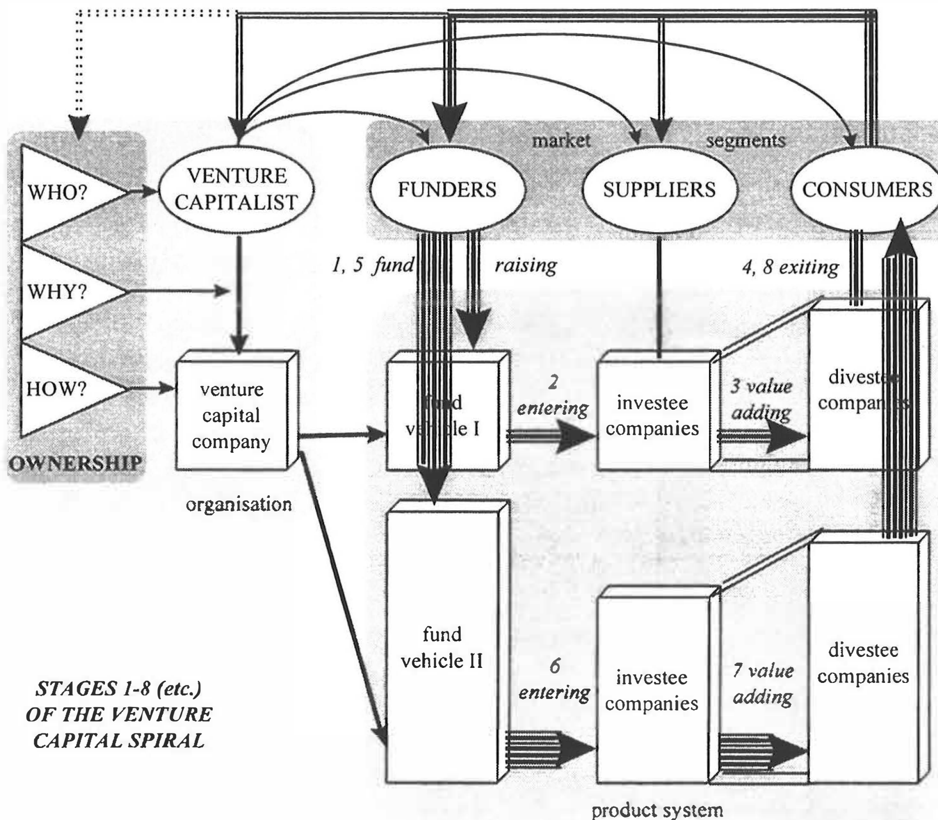

FIGURE 43 The strategy logic window on venture capitalism: The spiral view

Sketches of archetypes of venture capitalist strategy logic, derived from the synthesis of the four methodological approaches employed in this study, are presented in the next chapter.

7.1.3 Sketching archetypes of venture capitalist strategy logic

In venture capital, just like in any industry, firms differ in their 'orientation' regarding investors, production, and customers. Some firms are intensely production driven, while others concentrate on customer satisfaction. Some other companies are driven by 'ninety-day-spurts' in their service of the quarterly investor. In venture capital, this converts to *funder, supplier,* or *consumer* dominated archetypes of strategy logic. In the early days, when private venture capitalists were more or less in it for a hobby, no particular stakeholder 'dominated' the venture capitalist's operation, i.e., he was not *dependent* on any group. Consequently, dependence on *at least* one stakeholder could be established as a benchmark for *professional* venture capital activity.

The archetypes of venture capitalist strategy logic presented on the pages to follow are of kin to Galbraith (1983) and Mintzberg (1988) - efforts 'to locate the core business'. Galbraith (1983) works from the notion that industries have natural sequences or stages. He concludes that organisations within industries may operate along a number of the stages but favour one, as its "centre of gravity" - the stage at which it focuses its attention, in a sense where its "collective mind" lies (Mintzberg 1988: 6). With regard to venture capital companies, search for business core, or strategy logic, more than naturally folds around the venture capital process, looked at through the spiral view.

Due to the complex nature of the object, the archetypes presented herein seek not to be exclusive illustrations but (rather) rough sketches of the main types. The key objective is to address the essential differences between venture capitalists and, hence, caricature-like elements may have become attached to the archetypes (at least such has not been avoided). All serve the interest to bring the most concrete research results to the attention of the reader as concretely as possible. Due to the evolving nature and all dynamism of venture capital activity, the following illustrations are, at best, 'still-shots' of venture capitalist strategy logic *as depicted at the present hour.*[194]

7.1.3.1 *Asset-managers*

Attributing the development to the *venture capital spiral,* a number of venture capital firms are either knowingly or unintentionally becoming an integrated part of the asset management industry. Their strategy logic approaches that of mutual fund management companies in that the *raising of additional funds* - increasing the size of their capital pool and, consequently, annual management fee revenue - becomes an objective in itself, instead of the investment process. As noted by Sahlman (1990), venture capital firms have the incentive to raise a maximum amount of funds, since the profit accruing from operations covered by management fee increases not linearly, but exponentially.

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194 Rather than 'camera' shots of reality, the following depictions are (at best) portraits *painted* of 'a moving target' and, as it is with any art, perhaps only *time* can tell their value.

This archetype is typically entrepreneurial (faced with a tendency to turn independent corporate), it is after financial returns and operates from a uniform owner base (dispersed if and when it becomes publicly-held). Figure 44 underscores the weight of fund raising to this archetype.

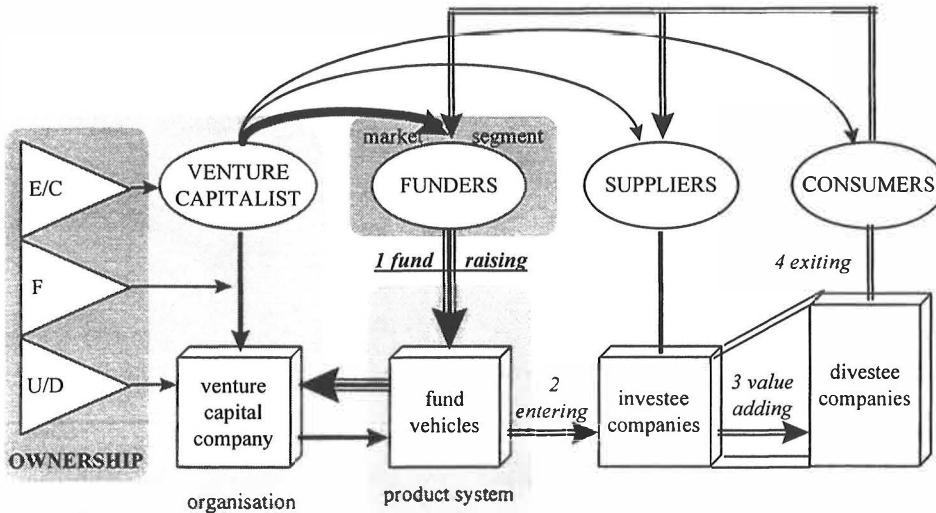

FIGURE 44 Archetypes of venture capitalist strategy logic: *Asset-manager*

As can be seen from figure 44, analysed by the product-market measure, 'asset managers' are not effectively *strategically* engaged in entering, value-adding, and exiting. Funders are their dominating stakeholder and market segment, and they are, by essential nature: *Fee generating asset-class-fiduciaries for funders.*

In a private professional conversation in 1996, in London, a director of a large venture capital organisation explained his unawareness of the investment criteria of a particular fund using the most eye-opening terminology.

> "Oh, I am not on the investment side. I am on the *business* side. We are responsible for investor relations and the raising of new funds. The investment side is responsible for getting the funds invested."

7.1.3.2 *Venture-bankers*

This archetype is an extension of the banking industry to whom the venture capital business is, essentially, *financing*. A typical 'venture-banker' is a venturing arm of a commercial bank, driven by predominantly financial gains but, often, with an eye also on the strategic interests of the parent.

As can be noted from figure 45, the product-market strategy of the 'venture-banker' is clearly different from the 'asset-manager'. For this archetype *suppliers* are the dominating stakeholder and market segment. An interesting feature for this type is the 'up-front' nature of exiting. A 'venture-banker' seeks to earn directly from each transaction closed with an investee. For them, value-

adding is an *even less critical output* than to the 'asset-manager'. 'Venture-bankers' can be described as being: *Financiers contracting financing with suppliers.*

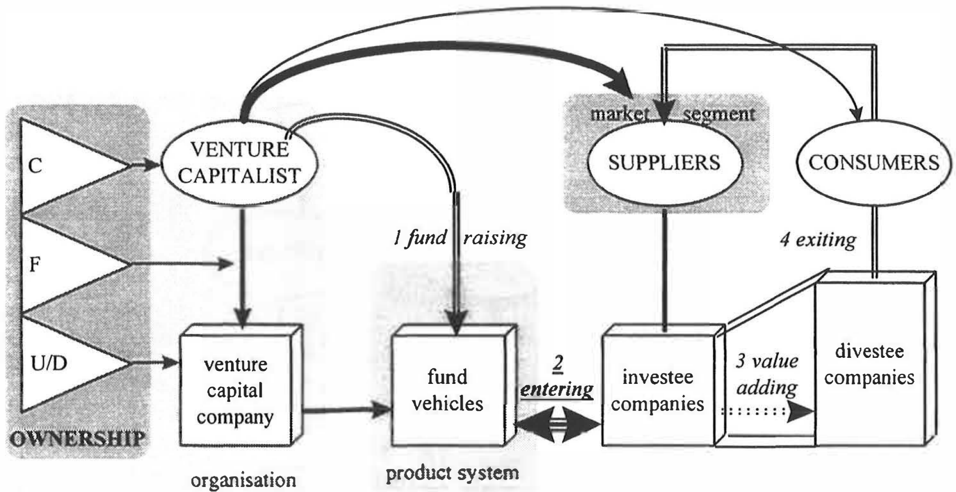

FIGURE 45 Archetypes of venture capitalist strategy logic: *Venture-banker*

7.1.3.3 *Empire-builders*

An 'empire-builder' is typically a publicly-held single LTD structure. Due to a dispersed owner-base, it is often classified as an *independent corporate,* although the management's control over the venture capitalist's affairs is notable.

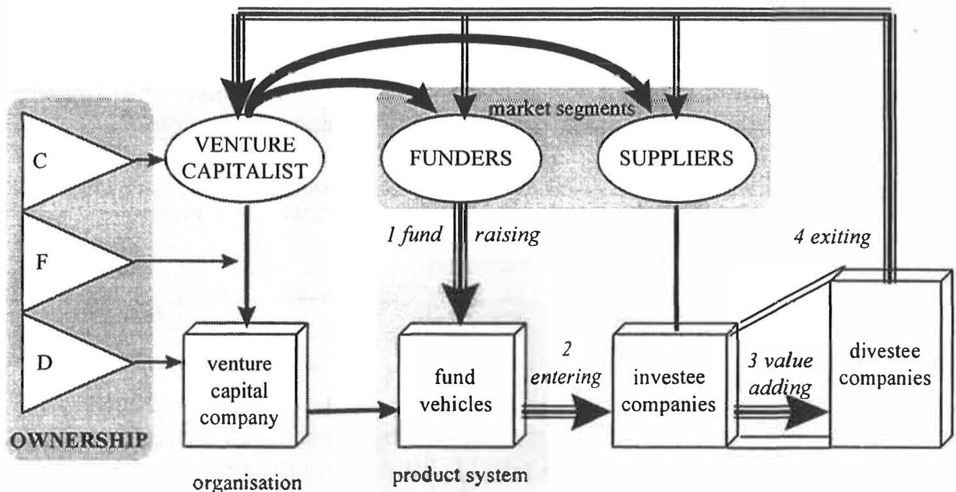

FIGURE 46 Archetypes of venture capitalist strategy logic: *Empire-builder*

The product-market strategy of an 'empire-builder' is depicted in figure 46 and, as can be seen, it operates actively within two market segments: *Funders* and

suppliers, but only has *one product* in its system. Value-adding is more relevant to this archetype than the two listed above. The archetype can be characterised as: *Listed groups seeking funders and suppliers for keeps.*

7.1.3.4 *Bounty-hunters*

The classic corporate venturing firm becomes depicted as a 'bounty-hunter' due to the fact that they are, unlike any other group, out on the market with a clear *incentive* to use venture capital - the growth serum so desired by entrepreneurs - as a 'Trojan horse' to achieve strategic interests of their parent companies. The archetype is, by definition, *captive corporate*, after strategic gains and operated from a uniform owner-base.

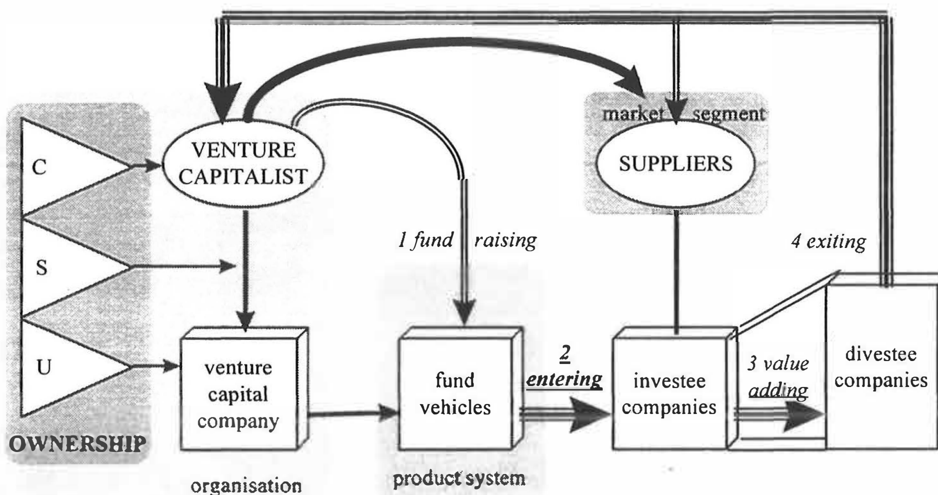

FIGURE 47 Archetypes of venture capitalist strategy logic: *Bounty-hunter*

As illustrated in figure 47, the product-market depiction of 'bounty-hunters' is of kin to that of the 'venture-banker'. This is not surprising since the 'venture-banker' is, after all, the (industrial) 'bounty-hunter's' (financial) cousin. The main difference is in the relationship of the two types to value-adding and exiting. The 'bounty-hunter' is active in value-adding, whereas the 'venture-banker' may lack incentive there entirely. Exiting takes place after the value-adding work is completed and the 'divestee' can be 'dis-divested', i.e., absorbed within the parent's group structure. The archetype comprises characteristically of: *Captive units seeking suppliers for parents' desires.*

It is imperative that the missions of venture capitalists and entrepreneurs are aligned. If they diverge, a "green eye" syndrome develops whereby the entrepreneur begins to question the venture capitalist, and *vice versa*. "Parallel goals and objectives and the ability to pull in the same direction result in a healthy entrepreneur-venture capitalist relationship." (Davis 1986: 109.)

7.1.3.5 *Care-takers*

This archetype is (typically) governmentally owned, either national (state) or regional (municipal/county) government-controlled. The ownership base is typically uniform, but it can also be formed on a dispersed owner-base (there are examples of regional such companies in Finland). A 'care-taker' is, by definition, after indirect strategic, economic-policy related gains.

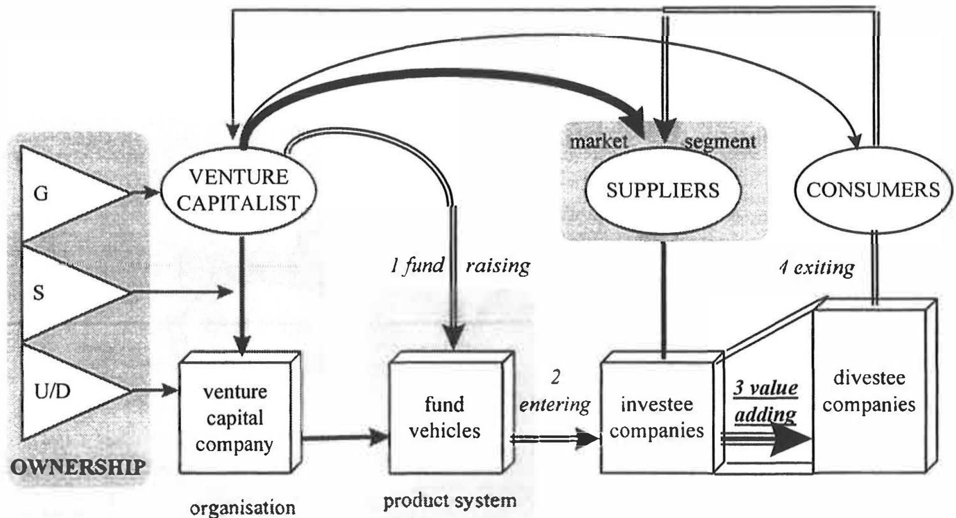

FIGURE 48 Archetypes of venture capitalist strategy logic: *Care-taker*

As evident from figure 48, 'care-takers' are the *country cousin* of the financial and industrial captive archetypes, 'venture-bankers' and 'bounty-hunters'. For the 'care-taker,' the value adding stage is the *ding an sich*. For this archetype, fund raising is an antithesis and entering and exiting technical, though *necessary*, stages on both sides of the value adding stage. 'Care-takers' can be described as: *National or regional public agencies doping-up suppliers.*

Mintzberg (1988: 59-61) makes the note that as industries change enterprises face the challenge of relocating 'centres of gravity' *between businesses.* As he points out, even non-profit organisations may face such challenge (e.g., a vaccine that would completely cure AIDS, would do many such organisations obsolete). They would have to relocate their 'centre of gravity' or, in simpler terms, as Mintzberg (1988: 61) phrased, "to find another reason to exist," which could prove to be a long and difficult process.

7.1.3.6 *Interim-owners*

This is the archetype constructed via 'artificial insemination', in chapter 3, based on conceptual constructing around the venture capital topic and, admittedly, deriving from the personal experience of the researcher. This archetype is not completely free from *normative* characteristics (on the other hand, as referred to

in chapter 1, ending up with something in that category was not excluded from among potential outcomes of the research). While the archetype is laden with elements from the Doriot school of venture capital, we could also find very close matches with this archetype from among buyout specialists, in particular.

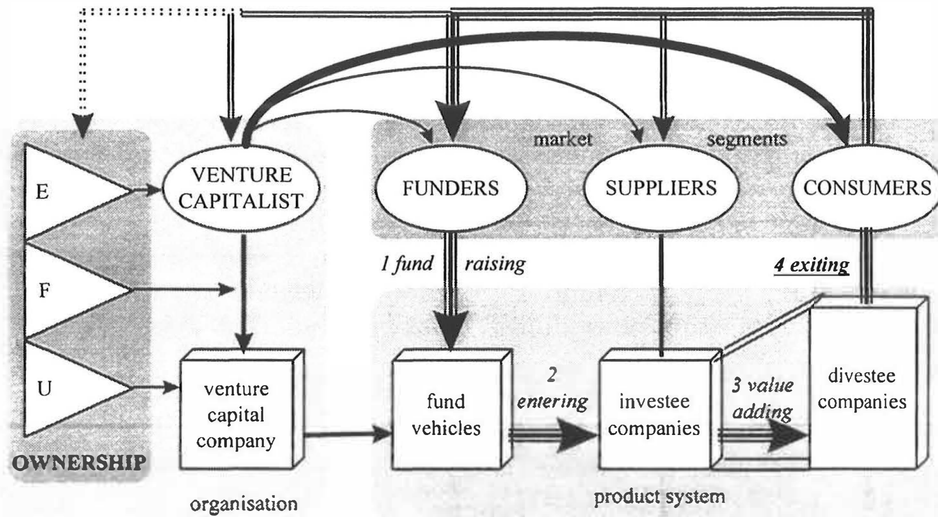

FIGURE 49 Archetypes of venture capitalist strategy logic: *Interim-owner*

The 'interim-owner' is the entrepreneur of the investor market, who enters companies to build value where he envisions that such can be realised on the market. As illustrated in figure 49, interim-owners' are typically entrepreneurial, financially driven, uniform owner-base companies to whom all of the stages of the venture capital process are of equal importance: *Exiting* being the clear point of culmination, however. This archetype is best described as: *Builders and governors of consumer value.*

More precisely, the business of an 'interim-owner' is establishing and/or adding investor value in carefully selected investee companies. Success is measured in terms of return on investment from the profits made when the shares are sold at exit. Venture capital is put to work in companies where professional ownership is needed to unlock shareholder value. This holds with both entrepreneurial start-ups and later stage buyouts. With early-stage ventures, the need for a venture capitalist is in the investors' lack of confidence on the owner-managers' will and ability to establish and preserve shareholder value towards an expansion of ownership. In later-stage situations, the need is born from lost confidence in the hired management running the public (dispersed-ownership) corporation.

7.1.4 Contribution and assessment of the study

The main contribution of this study, the *exposition of venture capitalist strategy logic*, is a result of inductive exploratory work conducted in 1987-2000 by a researcher who personally participated in the subject phenomenon in varying roles, in 1986-1996. Due to the nature and setting of the research, considerable empirical effort (both survey and case analyses) has been taken to probe the validity of the framework and the typology constructed in the study. In addition, the final analysis of the data as well as the reporting have taken place in 1997-2000, i.e., at a great distance from the industry (which should also serve to minimise concern for a potential industry bias of the researcher).

The founding thesis of the study that *our understanding of the venture capital phenomenon is insufficient*, has become addressed by creating a strategy logic approach to the study of venture capitalism and demonstrating that venture capital is, besides many other things, *also* a business: That there are, in fact, several businesses within.

The thesis that *we have missed a point when defining a venture capitalist* has become addressed by demonstrating the relevance of the controlling owner of a venture capital company to strategy logic and, hence, as the so-far neglected true identity of the venture capitalist.

The thesis that *our picture is incomplete as to how venture capital companies earn their living* has become addressed by demonstrating how differently venture capital companies employ the venture capital process in the pursuit of a *rich variety* of missions (hidden agendas).

The thesis that *there is a need for new management tools in the venture capital industry* has become addressed by demonstrating how the venture capital process has become converted from a stairway into a spiral constituting for constant pressures for strategic renewal at the individual company level. The buyers of the venture capitalists' portfolio stakes, the consumers, have become introduced as the *forgotten stakeholder* of the *venture capital spiral*.

Finally, the thesis that *recent developments observed in venture capitalism can advance our theory of the firm* has become addressed by reflecting the discussion towards the positions of two of the presently competing theories of the firm, 'shareholderism' and the 'stakeholderism'.[195]

The study can be also seen as an attempt to synthesise the existing literature on the venture capital company. Although far from conclusive as such an exercise, it is still postulated that a contribution has been made by knitting together related discussions or approaches from different disciplines, notably corporate strategy, financial economics, and entrepreneurship. In this study, propositions for directions of further research have been collected under the header: *Looking into the future of venture capitalism through the strategy logic window*. Rather than to elaborate on a variety of possible directions, perspectives, and approaches, the aim is to propose a concise vision of the future. Though building upon empirically-embedded theorising and 'educated

195 The discussion will be further elaborated upon in the final chapter of this dissertation.

foresight', it is up to each reader to decide whether the vision reflects a pursuable reality or is more like a mirage of a non-existing oasis.

This is the first doctoral dissertation in Finland on venture capitalism (the business of the venture capitalist). It provides a historical analysis of the industry's evolution starting from its roots in America, and reflecting also the conceptual development in the language describing the phenomenon. In this light, the work accomplished perfectly complements Virtanen (1996), the seminal Finnish thesis in the broader arena of venture capital research. In the present study, venture capitalists are followed *up the* (family) *tree,* in America, and *down the tree,* in Finland: From private enterprising to increasingly institutional forms of activity and back. In the final analysis, a looming third coming of venture capitalists (*back up the tree*) is depicted for Finland - and beyond - projecting a new wave of *public venture capitalism.*

Table 39 summarises the key features of the archetypes of venture capitalist strategy logic sketched in the study. It presents in a nutshell the *ownership questions* (who, why, how) and the *strategy issues* (what, how, to whom) as well as indicates the 'gravity centre' within the *venture capital spiral* located for each archetype.

TABLE 39 Summary features of the archetypes of strategy logic

ARCHE-TYPES	*Asset-manager*	*Venture-banker*	*Empire-builder*	*Bounty-hunter*	*Care-taker*	*Interim-owner*
Ownership	Indep.corp. or Entrepreneur	Corporate or Entrepreneur	Independent corporate	Captive corporate	Nat./regional Governmental	Entrepreneur or Indep.corp.
Mission	Financial gains	Financial gains	Financial gains	Strategic gains	Strategic gains	Financial gains
Governance	Uniform or owner-mgmt	Uniform or owner-mgmt	Dispersed	Uniform	Uniform or dispersed	Owner-managed
Organisation	LTD firm manages LP funds	LTD firm manages LP funds	Single LTD structure	Single LTD structure	Single LTD structure	LTD firm manages LP funds
Key product	Fund (as a *financial instrument*)	Fund (as *financing* available)	Fund (as *means of attraction*)	Fund (as *means of attraction*)	Fund (as *vehicle to subsidise*)	Divestee company
Key market segment	Funders	Suppliers	Suppliers	Suppliers	Suppliers	Consumers
Key stages of the venture capital spiral	*Fund-raising* (entering, value-adding, exiting)	(fund-raising) *Entering*	Fund-raising *Entering* Value-adding	*Entering* Value-adding	(entering) *Value-adding* (exiting)	Fund-raising Entering Value-adding *Exiting*

7.2 Looking into the future of the venture capitalist through the strategy logic window

> "The money man doesn't control anything. That guy going home every night with the technology in his head is the asset, and if he sits down on you, you're dead." (Peter Brooke in an interview by Fortune 1987: February 2.)

In the modern business environment, where *information* - rather than cash - is the king, intangible assets (such as *employees' knowledge*) have overcome machines and other tangible assets in many industries. As the *employees' brains* cannot be owned, employers have begun tying their key employees to share-ownership via option schemes and other arrangements. Venture capitalism presents a competitive alternative to the large corporation setting in that it offers a more powerful tool for the job by allowing the 'employees' - both at the venture capital company and the portfolio company level - hold a significant amount of stock from the start (as entrepreneurs), and not only through option arrangements. This is important *mentally*, and certainly more committing.

Sahlman (1990) noted that venture capital companies perform *economic functions similar* to those of corporations. Venture capital firms are only a much more recent phenomenon.[196] And this young industry is likely to experience similar developments than industries before it. Originally, venture capital, too, was a *production* (value-adding) driven industry; with General Doriot and the likes in the business of 'building men and their companies'. At present, the industry in increasingly *funder* (fund-raising) driven as an increasing number of venture capital companies resemble 'asset-managers'. It is the prediction of this study that the industry will eventually (be pressured to) turn more *consumer* (exiting) driven.

As early as a quarter of a century ago, Shames (1974) insightfully projected a dividing line that would emerge and 'cut through' venture capitalism. In the language of this study, venture capitalists are projected to become divided (professionally) into *owners* and *investors*. One half of venture capitalists will become positioned more clearly into the *investment management* cadre, whereas the other half will specialise in *ownership management*. Reporting an interview with an industry executive, Shames (1974: 126), himself a venture capitalist, projected the division of labour with the following words:

> "A third operating approach is presently being organised by a prominent hedge fund. They have taken the position that venture capital groups have the problem of not wanting to be intimately involved in the operations of a company in which they have invested; the venture capitalist does not want to get tough. Their plan is to represent the venture capital groups who will pay them a small annual fee to handle the job of staying involved with the embryonic company."

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[196] Ten years ago, Sahlman (1990) still could underline that, "though the economic resources under management are modest, the model seems to have been effective." The past decade has witnessed a tremendous growth of the capital pool controlled by the venture capital industry.

7.2.1 Towards *Ownership Management* theory?

Research on the venture capital phenomenon has, by definition, always been interdisciplinary. Ever since the seminal contribution by Tyebjee and Bruno (1981), the field has developed as an independent arena of research, but regardless of the explosion of the industry's scope and magnitude (or due to it), the field looks increasingly scattered. It is being visited from various established research domains or disciplines such as management, marketing, finance, and economics - other buoyant fields such as entrepreneurship - as well as from many practical camps: Such as government policy-makers, entrepreneur-associations, and investor organisations.

An effort has been made in this study to bridge the discussions related to the venture capitalist. A time of great *cross-continental* mergers and acquisitions, ranging from car manufacturing to banking, may be a good 'social foundation' to discuss 'cross-continental' mergers also within the scholarly community. If venture capital research has followed the *convergence development* (McGrath 1964) - whereby exploratory studies lead to the development of hypotheses, to hypothesis testing, and to validation and cross-validation - an *inward spiral* may have resulted, as depicted by Churchill and Lewis (1986). Such a spiral is, at worst, blinding in observing leaps of development in the phenomenon addressed. As pointed out by Freeman and Lorange (1985), narrow empiricism may lead to theories which lack conceptual richness and insight, and thus "theory validation is 'an academic exercise' in the most pejorative sense of that phrase." Perhaps a new spiral needs to be inaugurated.

While the prevailing theories of the firm, including agency theory based *shareholderism* (Jensen and Meckling 1976) and *stakeholderism* (Rhenman and Stymne 1965, Freeman 1984), are born from the study of the large corporation, the smaller entrepreneurial companies do not fit well into their frameworks. Both theories build on the notion of separation of ownership from control, shareholderism on a *concern* (as underlined, e.g., by Williamson 1988) and stakeholderism on an *opportunity* related to corporate control. Shareholderism fortifies around distant investors, extracted from control by hired managers (at whose 'mercy' the investors are), whereas stakeholderism fortifies around hired managers, pressured unfairly by distant investors (at whose 'mercy' the managers are).

The conflict between the world-views or standpoints of these theories - centering upon the debate on *who* owns the firm - is perhaps solvable, however. Something is missing from between the two - in more than one sense of the word. At one extreme, shareholderists drive managers to most short-sighted profit maximisation at the (truly unfair) expense of other stakeholders, including society at large. In the other extreme, stakeholderists drive managers to politicising around the corporation at the (truly unfair) expense of investors and - eventually - society at large. In both extremes, a lot of energy is wasted on contractual, legal aspects, and politicising around the firm - instead of zeroing in on how to build business for the long term.

Research on entrepreneurship could be seen working a third theory of the firm, one *not* building on the notion of separation of ownership from control, but the stage preceding: An individual's desire to create value by building a business. Once the best of entrepreneurs are through with their missions, *and leave the scene* to professional management, the corporation enters the battle field between shareholderists and stakeholderists. But like Ansoff's (1988: 165-172) new corporate strategy points out, there is "the need for entrepreneurial capability" also in the life of the more seasoned companies. The problem is that *entrepreneurial behaviour* and *competitive behaviour* are very different and that the *administrative structures* required by them are also very different: "The reward-and-value system [of a competitive organisation] actually punishes, rather than rewards, entrepreneurial risk tactics."

In other words, entrepreneurship is not a machine that could be mechanically engineered and implanted into a corporation. According to Ansoff (1988: 169), this has been increasingly recognised since the 1970s.[197] It is increasingly acknowledged that venture capitalism is not such a machine either - that one needs a *venture capitalist* to make venture capital work in an economy. Likewise, it can be concluded that *owners* are needed to make *ownership* work within a corporation. Perhaps venture capitalists, as 'owners of owners' (as postulated in this study) and as the 'entrepreneurs of finance' (Henderson 1988; see also Adler 1983), are providing solution as a new cadre of *ownership managers* in the corporate reality. Figure 50 presents the key theoretical discussions around the venture capital phenomenon that are seen to have contributed to the recognition of the field of *ownership management*.

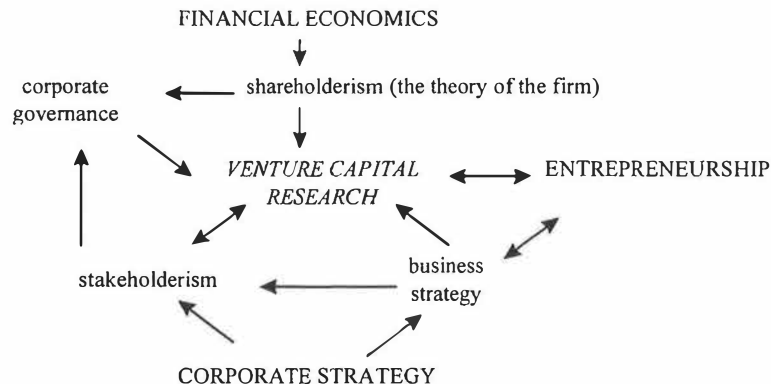

FIGURE 50 Theory roots of ownership management mapped

Stevenson and Harmeling (1990) encourage to challenge the existing models and truths. To them business and organisational theory must "ultimately be the most imperfect of sciences" because there are too many variables involved, *too*

197 Stevenson and Sahlman (1986) found "signs of an entrepreneurial revolution" and shed light on the dynamics of the entrepreneurial organisation.

many human factors. They remind us that theories are *tools*, not *truths*, serving as "walking sticks" in our growing understanding of the concept of the "entrepreneurial organisation in society;" and quote Schumpeter (1942):

> "Capitalism is by nature a form or method of economic change and not only never is but never can be stationary. The fundamental impulse that sets and keeps the capitalistic engine in motion comes from the new consumers' goods, the new methods of production or transportation, the new markets, the new forms of industrial organisation that capitalist enterprise creates. This process of Creative Destruction is the essential fact about capitalism. It is what capitalism consists in and what every capitalist concern had got to live in."

As praised by Wilson (1986: 203): "Schumpeter went on to describe the entrepreneurial function in terms that sound like a job description for a venture capitalist: 'This function does not essentially consist in either inventing anything or otherwise creating the conditions which the enterprise exploits. It consists of getting things done'." If previous research has worked towards "professionalisation of entrepreneurship" (as appraised by Wilson 1986: 211), this study could be seen as *early drafting* towards *professionalisation of ownership*.

Adam Smith's Wealth of Nations was a sharp account of the corporation. In 1776, at the dawn of the industrial revolution and the emergence of the *corporate management profession*, the potential for a *managerial revolution* (recorded later by Berle and Means 1933) was already noted. From the separation of ownership from control, and accelerated dispersion of corporate ownership, the *investment management profession* has emerged: "It is only the last few decades that money management has become a profession" (Shames 1974: 107-108). Jensen's (1989a, 1989b) accounts of LBOs as tools to restore owner-control in large corporations could be said to mark the emergence of the *ownership management profession*. According to Klaasen and Allen (1980: 2): "Venture capital is an investment in a business where the uncertainties have yet to be reduced to risks subject to the rational criteria used by securities analysts." The *divergence of management professions* is depicted in figure 51.

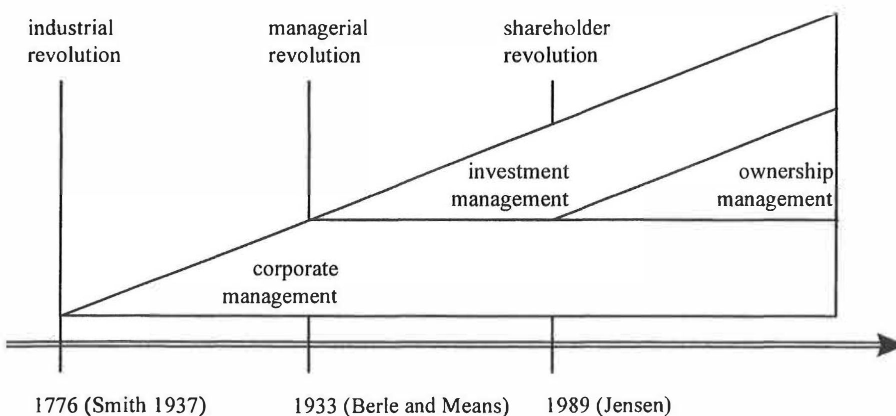

FIGURE 51 Divergence of management professions

7.2.2 Venture capitalists as *owners* operating between *investors* and *managers*

Daems (1978: 122) concludes that holding companies exist, fundamentally, because "capitalists have conflicting interests. Contrary to what is claimed by Marxists, such investors do not form a homogeneous group. Conflicts of interest arise among them because of uncertainty, differences in beliefs about the likely occurrence of certain events and because of incomplete markets. Even if companies maximise profits as much as possible in all states of the world, investors will disagree about policies pursued."[198] Ahead of his time, the *holding company* is characterised by Daems as "a [European] invention of financial capitalism meant to structure the corporate control market." Eleven years later, Jensen (1989a) made a similar notion regarding the role of the *LBO association* in the American economy. Coincidentally, another eleven years have passed before the present effort to combine the European and American perspectives, insights, and conclusions - towards a deeper understanding of *venture capitalism* - has become completed.

The American market economy has worked to refine the *investment manager's* profession, the essence of which is captured by Whitley (1997) below:

> "Capital markets in the post-war period have become dominated by institutional investors and fund managers who compete for investment returns on diversified portfolios or shareholdings and remain distant from the fortunes and activities of any one firm they invest in. Because *investors* are not committed to the future of any one company, they do not develop much expertise in its products, technologies, or markets and generally prefer to sell their shares than intervene when problems arise. Thus, capital market financial systems generate strong markets for corporate control in which ownership can change quite rapidly and businesses are bought and sold in the same way as commodities in general." "Whitley 1997:246-247; emphasis added.)

In the European arena, circumstances have been better suited for the refinement of the *ownership manager's* profession; although often from the lender's, not shareholder's perspective, as noted by Whitley (1997).

> "Conversely, where banks and other investors are effectively 'locked in' to share ownership and/or share trusteeship of specific businesses, they have to develop longer-term and broader interests in their growth and development... Investors here develop more elaborate monitoring skills and knowledge about specific client's products, technologies, and markets so that they can evaluate particular risks more effectively and, over time, offer informed advice about opportunities and strategic choices. Credit-based financial systems in general *develop broad owner interests* because they, and/or their agents such as banks, trustees, and other intermediaries, cannot easily sell their shares on large, liquid, and anonymous capital markets and so are exposed to higher levels of risk for individual investments than owners in capital market based financial systems." (Whitley 1997:247; emphasis added.)

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[198] Daems (1978: 122) illustrates his empirical finding with a brilliant, almost biblical example: "Assume that several fishermen, all equally experienced, are co-owners of *one* fishing net. All the fishermen have a subjective probability distribution over the location of a fish shoal in a lake. One fisherman, however, *strongly* believes that he has prior information which permits him to locate the shoal of fish exactly. Such an individual will, to a certain extent, be willing to pay a price for the right to throw out the fishing net."

Table 40 drafts out the earning logic differentiating *investors, owners,* and *managers* from each other by professional focus.

TABLE 40 Rough classification of investors, owners, and managers by basic earning logic

Actor	*Profession*	*Earning logic*
INVESTOR	INVESTMENT MANAGER	speculation on values of publicly held shares short-to-long term ownership in a *large number* of companies
OWNER	OWNERSHIP MANAGER	unlock shareholder value in undervalued companies medium term ownership in a *limited number* of companies
MANAGER	CORPORATE MANAGER	produce returns on corporate assets long term to permanent ownership in *one* company

Koski (1988: 85-86) classifies corporate shareholders as:
(1) *Latent or passive investors,* who represent a grey mass of owners whose behaviour in normal circumstances can be well predicted but whose latent threat to equilibrium can be activated by crisis situations or sudden environmental changes.
(2) *Speculative investors,* whose primary interest is in high return as fast as possible through selling and buying corporate stock in accordance with market trends.
(3) *Interventionist investors,* who differ from speculative investors by their interest in power in corporate affairs for the purpose of influencing the restructuring of corporate assets.
(4) *Cooperative investors,* whose motive is to participate in strategy formulation for long-term mutual benefit of corporation and investor.

Though based on semantically different orientation, the typology proposed by Koski (1988) is most stimulating also for this investigation. Koski approaches the ownership topic from the corporate management's perspective working in the interest of increasing management's awareness of the differencies in behaviour of different types of shareholders and the dynamics related to differently composed 'ownership portfolios', i.e., shareholder bases. His objective is to provide corporate management with a new conceptual tool on 'the management of the corporate shareholder base'. It is his bottom line, as it is for the present study, that ownership (who owns) makes a difference to management (strategy).

In the perspective of this study, it is most relevant to review how Koski (1988) describes the behaviour of interventionist investors. Pondering upon the impact of ownership strategy on corporate strategy at SBU level in high technology environment, Koski (1988: 86-93) finds interventionists as "parties to corporate striptease," when the SBU's competitive advantage is based on technology capability: Interested in spinning out or divesting the unit in order to realise significant one-time gains. In such a case, their contribution to

competitive advantage is "limited to their interest in asset development." When the competitive advantage is based on product market fit, interventionists "in their venture capitalistic mode can serve as linkage to the other players in a particular marketplace if this serves their asset development interests or increases the pressure to divest."

Addressing the corporation level, Koski (1988: 93-103) finds the interventionist shareholders, by definition, in search for control "in order to be able to restructure the corporation so as to increase the market value of the company and/or its parts to the highest possible level. This goal, of course, requires attention to an industry in order to find interesting 'corporate candidates' for investment targets. It also requires professional knowledge about the industry's overall behaviour."

"Interventionists see the industry life cycle as a playground in which to develop assets over the entire period from start-up through growth to maturity in such a way as to optimise their total utility. Interventionists differ from speculators primarily in seeking to cause restructuring in the corporation's mature businesses in order to optimise their total utility. Their attitude toward start-up phase is thus venture-capitalistic, toward growth phase speculative, and toward maturity phase finance-driven restructuring." Koski (1988: 117).

Figure 52 provides an illustration of investment managers (investors), ownership managers (owners), and corporate managers (managers) at work.

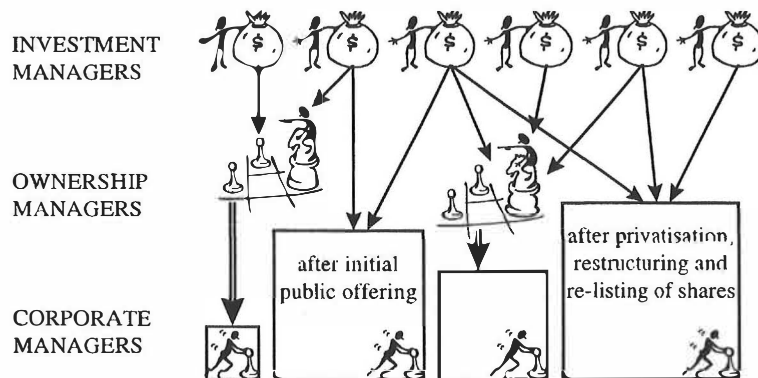

FIGURE 52 The differing roles of investors, owners, and managers depicted

Attributing the notion to Koski (1988), there are two directions to ownership management; for the owners to manage *down* and for the managers to manage *up*. According to Koski (1988), corporate managers should manage *up*, i.e., have an investor strategy and actively manage their shareholder base, as well as down (business strategy), which is the traditional direction. Historically, managers have managed down, and only recently a cadre of investor relations (IR) managers has emerged to manage up; a phenomenon followed by IR management studies (for example, Tuominen 1995). It is in the interest of managers to not only passively inform investors but also to actively manage the investor base. If *managers* fail with *investors*, *owners* will emerge between.

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APPENDIX 1

UNDERSTANDING THE RESEARCH PHENOMENON

To study by whom, why, and how *certain kinds of firms* are established, owned and organised; what they produce, how, and to whom; may not sound like the most ambitious objective for a doctoral dissertation project but, when one's interest is in *venture capital*, ambitious it is.

The research setting has developed and matured throughout a lengthy, inductive research process, and it has largely benefited from the researcher's simultaneous participation in the phenomenon as a practitioner in 1986-1996. The final problem setting is a product of a ten-year learning process and, hence, a seminal research result in itself. Also, while the reporting reflects the researcher's 'final' understanding, it is important for the reader to go through the developments observed in the research phenomenon, and lived through by the researcher during the past thirteen years, in order to better understand the construction and perspective of this dissertation.

In 1987, this study was launched with a 'humble' mission: To make sense of a new business phenomenon booming in the Finnish economy. Eventually, the mission inevitably grew to making sense of *venture capitalism*, in general. In retrospect, as the awareness of the economic significance and global magnitude of the subject phenomenon - as well as of the broadness and complexity of the concepts around it - has only increased, the *research mission* can be said to have risen in 'market value'.

The initial selection of the research topic had to do with the researcher's B.Sc. thesis project (for which *a research topic had to be selected*) and his entry to an industry apprenticeship programme one year earlier. In late 1986, the researcher had entered the organisation of Panostaja Oy, one of the privately based companies established during Finland's first industry boom (1984-1986).[1] By year-end 1987, with one year of personal experience (and the industry celebrating its 20th anniversary in Finland), the research topic felt 'given'. In 1987, with no information on *venture capital* (as understood in America)[2] and no understanding (yet) of the link between the Finnish *kehitysyhtiö* phenomenon and *venture capitalism*, the subject phenomenon appeared to be a local experiment.[3] From the outset, the business involved making equity

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1 Before 1984, only one privately based venture capital company had existed (Mancon Oy, est. 1978), before which only the industry pioneer (governmental Sponsor Oy, est. 1967). During the late 1980's, Panostaja Oy was (in financial terms) one of the industry's most successful firms.

2 Until a 'transition period', during 1987-1989, *venture capital* (the actual English term) was very seldom referred to in literature and media in Finland but, to the extent it was, it was evident that the local equivalent for a venture capitalist was *kehitysyhtiö* (e. development company).

3 In 1984, a fiscal incentive scheme had been activated, by which the Ministry of Finance had the authority of deciding whether or not an applicant firm was considered to be an 'important developer of the Finnish industry', and hence worthy of an official status and a tax-break.

investments in firms that could not raise financing from the public market, active 'nursing' of the portfolio companies, and an idea of exit after a number of years, once the investees were mature enough for the market.

However, largely due to their *implemented* strategies, which already by late 1987 were noted to be quite different from their spoken missions and *implied* strategies, the true nature of the business and its players were the natural choices to be addressed in the study. Between 1984-1986 a total of 24 new venture capital companies had been established by various interest groups in order to make equity investments in private Finnish SMEs. This development was largely stimulated by the Ministry of Finance controlled fiscal incentive and the example of industry pioneers Sponsor and Mancon. Since the fiscal incentive made dividend-income from portfolio companies tax free, the newly incentivised venture capital companies understandably ended up acquiring majority interests in established, strong cash-flow based companies, often from retiring entrepreneurs. Also, some channelled investments in rather conservative, real estate dominated projects. Contrarily to the government's expectations, not many invested in minority-holdings in early-stage, entrepreneur-driven and new-technology-based companies.

In retrospect, it can be concluded that failed stakeholder expectations drew attention to the strategy logic of the venture capitalist. By the time, very much thanks to the fiscal incentive programme administered by the Ministry of Finance, the venture capital community was at an all-time peak of strength. Quantitatively, in terms of both capital and capitalists, the community was stronger than ever. Qualitatively, however, there seemed to be some reason for concern. On 9 November 1987, an anonymous *Kauppalehti* causerie, titled: *"Kehitysyhtiön tehtävä"* (e. Mission of the venture capital company), bitterly appraised the local venture capital community as follows:

> "A few years ago, a hot *business idea* circulated the world and the nation: Let's put money into small firms with great future potential and cash out the stock once the firm value has increased. *Let's establish a venture capital company. Socially respectable and honest business that brings home nice profits. So it was believed. Reality is different.* Most of the venture capital companies are fighting on a downhill surface - with their noses barely above the water. There are three types of typical portfolio firms: First, firms with rotten capital structure, second, firms with unprofitable business operations, and, third, firms with rotten capital structure and unprofitable business operations. It is typical of venture capital companies to sell services to their portfolio firms. Consultants, equipped with laptop computers and mobile telephones, travel around the country selling their 'expertise.' Afterwards, the venture capital company sends an invoice to the portfolio firm. Portfolio firms have to pay for having the day's work undone and the staff listen to the same old boring consultant stories. The situation is absurd. *The only explanation for the empty minded force-selling [of services] is that the short-sighted venture capital companies have to generate revenues. This helps to present operational profits. And profitable venture capital business."* (emphasis added).[4]

As disputable and subjective as it may be, the above text is an eye-opening account. It builds a colourful case illustrating that there is more to a *strong*

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4 An excerpt found fresh from the *coffee room notice board at Panostaja Oy* in November 1987.

venture capital community, in the Brophy's (1986) sense of the word, than the *quantity* of the drug. It helped realise that in venture capital as in any other business, *someone* is needed to 'doctor' the business process from idea to action, to the offering of certain products, in a certain way, to certain markets. Besides noting that the product-market strategies of venture capital companies may appear unexpected, if not confusing, the causerie ends up heavily underlining the role of *the one in control* of the venture capital company.

With important spark from the media, the venture capitalists became identified early on in the process as the *persons in control of the venture capital process.*[5] Likewise, it became established early on that venture capital companies exist as vehicles of their owners.

By illustrating how distant the (perceived) outcome of venture capital investing could be from its (perceived) economic potential, and how strong sentiments can be involved, the above causerie reports the triggering observation to this study. Venture capital firms *do not exist to provide 'medicine' to an economy,* after all. They *exist to serve the interests of their owners – the 'doctors' of the venture capital process.* Hence, besides 'clinical' (environment) conditions, the interests and qualities of the doctor appeared to be integral to the hoped-for, revitalising medicine value of venture capital investing to an entire economy.

By the time the research matured into an M.Sc. thesis (in 1989), the scholarly investigation on the origin of the *kehitysyhtiö* phenomenon had resulted, first, in the notion of kinship to a similar phenomenon in Sweden and, second, in the understanding that these both had emerged - together with other European variations - from a 'venture capital root' in America. Differences in economic and cultural fundamentals, in the operative environment of the industry, had simply produced quite different industry settings and traditions in Europe versus America. This was quite an important conclusion.[6] The formal venture capital industry had emerged on the new continent, right after World War II, in an economy where starting a company, running it for rapid growth, and (later) taking the firm public, were cherished as elements of the American dream. During its first decades, the industry profiled itself with successful investments by wealthy individual venture capitalists in entrepreneur-driven, high technology based early-stage companies.

In the 1960s, the venture capital process was imported to Europe - mainly by governments - to be employed in economic development. In the old continent, entrepreneurial start-ups and rapid creation of new wealth historically enjoy less appreciation and encouragement both for cultural and political reasons. In the European environment, majority acquisitions, buyouts of established companies and divisions thereof, and restructuring of entire industries provided a much more natural playground for venture capital activity. In many European countries, such as Finland, the English term *venture*

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5 Either natural persons (acting as *principals)* or legal persons (represented by natural persons acting as *agents*).

6 In 1989, the researcher attended an Executive Program at the Mississippi State University which greatly advanced his understanding of the phenomenon and the linkage between the American and European traditions.

capital was practically not referred to as a concept before the (late) 1980's. The national experiments on venture capital had started under different labels - often carrying national flavours - such as *kehitysyhtiö* in Finland.[7]

By 1990, following the insight that a related, European 'segment' had emerged from the classic American venture capital root, the research turned to comparing the *kehitysyhtiö* business and business of (classic) venture capitalists or *European vs. American venture capitalism.* At this stage, the reporting language was changed from Finnish to English, and it was decided that parts of the research would be conducted in America. The research subject was no longer labelled *kehitysyhtiö* but, more universally, a venture capital firm; variations of which were seen to serve different traditions: American and European.[8]

For decades, traditional venture capital investing had been thought of as *risk financing* for innovative, entrepreneur-driven start-up companies. The European variations (often involving investments in majority holdings of later stage, hired-management driven, less risky situations) were simply not to be referred to as *venture capital* to many industry observers. In many European countries (e.g., Finland, Sweden, and the UK), a distinction between the two traditions was being insisted since the late 1980s.

However, by the end of the 1980s, privatisation (de-listing) of poorly performing publicly held companies through leveraged buyouts (LBOs) and other acquisitions of established firms had permanently gained ground in the investment spectrum of venture capital firms also in America. *The classic definition of venture capital did no longer represent what was really happening in the industry.* The modern, global venture capital industry had outgrown its classic, historical definition and called for a new conceptualisation. Morris (1992) provides, in a nutshell, a comprehensive report of the actual involvement in economy of the modern venture capital industry.[9]

> "The venture capital industry today covers a broad spectrum of investments in the private equity market. In addition to providing seed and start-up financing for new businesses, venture capitalists also fund the expansion of companies that have already demonstrated the viability of their businesses but do not yet have access to the public securities market or to credit-oriented institutional funding sources such as banks or insurance companies. They also provide management/leveraged buyout financing. This financing assists operating management purchase and revitalise a division of a major corporation or an absentee-owned private company. Additionally, venture capitalists sometimes use their skills and experience in public stock market securities, where they perceive those companies to be undervalued. They will also participate in private placements of public companies." (Morris 1992.)

---

[7] Appraising venture *capital* as the *medicine* of economy appeared to be more politically correct, than appraising venture *capitalists* as the *doctors* of economy, in Europe (at least Finland) during the political stand-off of the cold war era. And, after almost ten years, the transition is not over.

[8] The research period based at the University of Oregon (1990-1991) was marked by extensive networking with established venture capital scholars and practitioners.

[9] In 1992, Jane Koloski Morris (industry observer since 1978) was VP Investor Services of Venture Economics Inc., the leading venture capital industry research and publishing company.

A broader definition for venture capital is still under a debate, however. Not everyone in the industry agrees to conceptually approve investors utilising the LBO technique as venture capitalists. Regardless of certain resistance to change, observations of the actual behaviour of the venture capital firms called the entire theoretical reasoning explaining the existence of the venture capital industry into question. A practical phenomenon - what companies actually do - seems to be in a conflict with its theoretical foundation.

> "The venture capital industry has reached a cross-roads, and the direction it takes will have serious implications for its future... Academics also have choices to make and new avenues to explore in their research and teaching. As fields of formal study, entrepreneurship and venture capital are in their adolescent stages; scholars have a chance to build solid intellectual foundations for both of them. The choices are there." (Bygrave and Timmons 1992: 323).

There is a continuous debate on how to define the venture capital industry, who qualify as venture capitalists, and why. Do all the various organisations engaged in venture capital investing, world-wide, form one (formal) industry, or is this a club of those belonging to a chain of national industry associations, or is there a yet deeper rationale?

The question leads to deliberate upon factors that firms *should have* in common, in order to form an industry. Webster's Ninth New Collegiate Dictionary (1989) defines the word *industry* as "a *distinct group* of *productive* or *profit-making* enterprises." What demands in economy do venture capital firms supply for as a *distinct group*? Do they share a distinct logic to produce (services) or to make profit? Simplified: Do they all serve a same function?

Classically, venture capital firms are thought of as *financiers* of entrepreneurial start-up companies, in the business of offering financing to enterprises that would otherwise stay outside the capital market, either due to early stage, unproved product or technology, or simply for lack of collateral. Their motivation for such risk financing is imaged as high return potential. According to this view, venture capital firms are a sort of bankers gambling on the margin between incoming and outgoing capital. However, thinking further of the earning logic, it is easily understood that the sale of capital, per se, is not enough for a venture capitalist - as it should be for a prudent (commercial) banker.

The venture capital firms provide equity-related financing and, besides potential dividends, gain profits from 'self-helped' increase in portfolio company value realised at exit. Thus, venture capital firms are *investors* rather than mere financiers. Moreover, since they do not make investments just 'to wait and see' as equity investors do in the public securities markets, but actively monitor and participate in value adding, they are *active owners* rather than passive investors. Growing from the recognition throughout the researcher's own industry career, of how central *active ownership* of portfolio companies is to all forms of venture capital investing, a new nuance in the function of venture capitalists has been discovered.

According to this view, venture capital firms live off the disability of public stock market investors, and inefficiency of capital markets at large, to monitor and influence corporate management, to process and establish corporate value as active *owners*, where necessary. In this light, venture capitalists exist to provide the investor community with the services of a professional owner. In other words, rather than bankers or brokers of capital, venture capitalists could be thought of as *professional owners*, processors and monitors of corporate value. With the research phenomenon again newly conceptualised - around 1992 - the research geared to understanding the importance of how venture capital firms themselves were owned and controlled and how this affected the logic of their own business as owners.

Looking at the venture capital firms from the ownership perspective resulted in some interesting initial observations. First, these are typically very closely held companies, with the exception of some publicly held entities. Second, in America, the first venture capital firms were established by wealthy, independent individuals, whereas in Finland (typically of Europe in general), by corporate or governmental entities. Furthermore, in America, the venture capital community predominantly consists of venture capital firms established and controlled by independent, individual partners, while in Finland firms established and/or controlled by the national or a local government still dominated the venture capital community few years ago.

The notion of such distinct differences in the ownership structures of the relatively closely held venture capital firms resulted in an interest to explore whether the differences in behaviour of venture capital firms could be better explained by differences in their ownership structure than the geographical location. The definition for a venture capitalist - the research subject - was finally anchored in the ownership of the venture capital firm and the research interest in exploring similarities and differences in strategy logic of the various venture capitalist types. In this study, a venture capitalist is defined as the controlling owner (or group of owners) of a venture capital firm. In the process, venture capitalists have become classified as either *entrepreneurial, corporate,* or *governmental*.

In the first, modest sketch paper of this investigation (Seppä 1987), the scope was to cover a local *kehitysyhtiö* phenomenon. Soon, a root was discovered in the classic American venture capital tradition, and the research was to compare two related phenomena, the European vs. American venture capital tradition. Finally, the two traditions were found integrated under one and the same *ownership* related phenomenon.

During this research process, between 1987-2000, the research phenomenon expanded twice. Many aspects of the original research setting either changed or disappeared. The core remained, however: Making sense of venture capitalism, of the *businesses* within.

APPENDIX 2

LIST OF VENTURE CAPITAL INDUSTRY CONFERENCES ATTENDED

1990	*Venture Connection*, Helsinki, Finland. Arranged by the Finnish Venture Capital Association (then named Finnish Venturing Association)
1990	*Venture Forum*, San Francisco, USA. Arranged by Venture Econmics, Inc.
1991	*Annual Meeting of the NVCA*, Washington, D.C., USA. Arranged by the National Venture Capital Association.
1991	*Venture Forum Europe*, London, UK. Arranged by Venture Econmics, Inc. and the Financial Times Group
1993	*Venture Forum Europe*, London, UK. Arranged by Venture Econmics, Inc. and the Financial Times Group
1994	*Annual Meeting of the Governors of the EBRD*, St. Petersburg, Russia. Arranged by the European Bank for Reconstruction and Development.
1995	*Venture Forum Europe*, London, UK. Arranged by Venture Econmics, Inc. and the Financial Times Group
1997	*Venture Forum Europe*, London, UK. Arranged by Venture Econmics, Inc. and the Financial Times Group
1997	*Pääomasijoitustoiminta* (venture capital activity), Helsinki, Finland. Arranged by the Institute for International Research

APPENDIX 3

SURVEY QUESTIONNAIRE 1989

TRANSLATION FROM FINNISH TO ENGLISH (As this questionnaire was constructed and processed in Finnish only, this translation is provided for information purposes only. Concerning sections 2, 3, and 4 of the questionnaire, only the questions utilised for the present analysis have been included.)

PART 1: DEMOGRAPHICS OF THE VENTURE CAPITAL COMPANY

1.1 FOUNDING THE VENTURE CAPITAL COMPANY

.1 Company name: ____________________
.2 Company hometown: ____________________
.3 Company founders: ____________________
.4 Year of the company's founding meeting: __________

Please express your view concerning factors that led to the founding of your venture capital company. Circle number 7 for the factor of the greatest influence, number 6 for the second greatest influence etc. Thus number 1 is circled for the factor that has the least influence among the given factors.

.5	Personal contribution of certain individual(s)	1	2	3	4	5	6	7
.6	There was a social call for a venture capital company	1	2	3	4	5	6	7
.7	Desire to help the Finnish economy and business firms	1	2	3	4	5	6	7
.8	Apparent business opportunity or market gap	1	2	3	4	5	6	7
.9	Capitalist pursuit to maximise profit with a new bus. idea	1	2	3	4	5	6	7
.10	Fiscal incentives or other such technical arguments	1	2	3	4	5	6	7
.11	Other factors (pls. specify): ____________	1	2	3	4	5	6	7

1.2 EQUITY AND OWNERS OF THE VENTURE CAPITAL COMPANY

.1 Founding equity and stock issue limits as set forth in the articles of association:

____

.2 Company's first shareholders and their proportion of stocks and votes at foundation (at least for the largest shareholders):

____

.3 Accumulation of equity from foundation to today (a) as was planned and (b) as did happen:

____

.4 List the most significant changes in ownership, dates of changes, and their effects on ownership structure:

____

.5 List the company's current shareholders and their proportions of stocks and votes:

____

Next, please classify your company from the ownership perspective by selecting one of the following alternatives

.6 My venture capital company is

- owned by private and corporate parties	1
- owned by public sector parties	2
- owned by a single corporation	3

Next, please express your opinion regarding the owners' influence on the strategy and policy of the venture capital company. Number 1 stands for small influence, number 3 for (compared to other issues) average influence and number 5 for big influence. Number 2 stands for fairly small influence and number 4 for fairly big influence.

.7	in the selection of investees	1	2	3	4	5
.8	as dividend requirements	1	2	3	4	5
.9	as fostering of entrepreneurial ideals	1	2	3	4	5
.10	on the 'institutional' level	1	2	3	4	5
.11	on the 'strategic' level	1	2	3	4	5
.12	on the 'business' level	1	2	3	4	5
.13	on the 'operative' level	1	2	3	4	5
.14	elsewhere, where __________	1	2	3	4	5

.15 How does your venture capital company relate to requirements to increase the value of company shares; are there such requirements and, if so, how do you seek to fulfil these owners' requirements?

____

____

1.3 ORGANISATION OF THE VENTURE CAPITAL COMPANY

.1 Amount of personnel in the year of foundation: ______

.2 Annual increases in personnel until 1988:

____

____

.3 Personnel's ownership of company equity since foundation:

____

____

Please comments the following statements. Number 1 stands for fully disagree, number 2 for disagree somewhat, number 3 for neutral, number 4 for agree somewhat, and number 5 for fully agree.

.4	Venture capital company personnel should include members that own equity in the firm (i.e., partners)	1	2	3	4	5
.5	It is important to create an entrepreneurial culture also inside the VC company	1	2	3	4	5
.6	The role of the board of directors is greater in venture capitalism than in 'conventional' business activity	1	2	3	4	5
.7	The organisation of a venture capital company should be light	1	2	3	4	5
.8	From the perspective of organisation and structure, venture capitalism slides towards conglomerate business, when majority stakes are primarily being acquired	1	2	3	4	5

.9 How are portfolio companies attached to your organisation structurally after you have made the investment?

____

____

PART 2: DEVELOPMENT OF THE BUSINESS IDEA AND OBJECTIVES OF THE VENTURE CAPITAL COMPANY

2.1 DEVELOPMENT OF THE BUSINESS IDEA OF THE VENTURE CAPITAL COMPANY

.1 Original business idea of the company:

____

____

.2 If the business idea has changed, dates of change and main substance of change

____

____

.3 If the business idea has changed, main reasons of change

____

____

.4 Current business idea of the company

____

____

Please indicate your opinion as to fulfilment of the company's original business idea. Number 1 stands for poor fulfilment, 5 for good fulfilment, 2-4 for fulfilment between the two.

The original business idea became fulfilled

.5	during the company's first years	1	2	3	4	5
.6	during the years thereafter	1	2	3	4	5
.7	during the latest years	1	2	3	4	5

Please comment the potential reasons for change of business idea. Number 1 stands for no influence on change, number 5 for major influence on change.

Reasons for change of business idea:

.8	poor development stage of stock market	1	2	3	4	5
.9	low level of stock market investing	1	2	3	4	5
.10	limited size of the Finnish market	1	2	3	4	5
.11	fiscal and related aspects	1	2	3	4	5
.12	insufficient human resources	1	2	3	4	5
.13	growing profit requirements by owners	1	2	3	4	5
.14	requirements by other stakeholders	1	2	3	4	5
.15	"forced" acquisitions of certain type firms	1	2	3	4	5
.16	lack of resources to acquire certain firms	1	2	3	4	5
.17	other reason, what: ____________	1	2	3	4	5

2.2 DEVELOPMENT OF THE OBJECTIVES OF THE VENTURE CAPITAL COMPANY

.1 Company's founding mission:

____

____

.2 Change of mission since foundation:

____

____

.3 Success in fulfilling the mission:

____

____

Please indicate your opinion. Number 1 stands for small, number 2 for fairly small, number 3 for average, number 4 for fairly big, and number 5 for big.

Importance of profitability for mission

.4	during the company's first years	1	2	3	4	5
.5	during the years thereafter	1	2	3	4	5
.6	during the latest years	1	2	3	4	5

Faith in the venture capital company's potential to develop the portfolio companies under minimum annual cash-outs, just waiting for the exiting profits

.7	during the company's first years	1	2	3	4	5
.8	during the years thereafter	1	2	3	4	5
.9	during the latest years	1	2	3	4	5

2.3 VENTURE VS. DEVELOPMENT -KEHITYSYHTIÖTOIMINTA

.1 Please define what is "kehitysyhtiötoiminta" (the Finnish word for venture capital company activity):

____

____

.2 What special characteristics are attached to the original, minority-position-seeking *venture* -type "kehitysyhtiötoiminta":

____

____

.3 How about *development* or *utvecklingsbolag* (kehitysyhtiö in Swedish) -type "kehitysyhtiötoiminta":

____

____

.4 Please position your company in the *venture-development* -axis:

____

____

Please indicate your opinion. Number 1 stands for small etc., and number 5 for big.

.5	possibilities to exercise venture-type "kehitysyhtiötoiminta" in Finland in 1975	1	2	3	4	5
.6	how about 1980	1	2	3	4	5
.7	how about 1985	1	2	3	4	5
.8	how about 1989	1	2	3	4	5
.9	how about 2000	1	2	3	4	5

Please comment the following statements. Number 1 stands for fully disagree, etc., and number 5 for fully agree.

.10	in 1985 there where only 1-2 venture -type "kehitysyhtiö"-firms in Finland	1	2	3	4	5
.11	Finnish "kehitysyhtiötoiminta" is largely to be seen as conglomerate building	1	2	3	4	5
.12	*venture* and *development* -type activities cannot both refer to kehitysyhtiö-firms	1	2	3	4	5

PART 3: VENTURE CAPITAL COMPANY ACTION IN THE PORTFOLIO COMPANY

3.1 VENTURE CAPITAL COMPANY INVESTMENT CRITERIA

.1 total investments made/total deals investigated/total deal flow/calendar year; development from foundation to today

____

____

(for example, 5/22/50/1985, if in 1985 your company's total deal flow comprised 50, if you investigated a total of 22, and ultimately made 5 investments)

Please express your opinion. Number 1 stands for little, number 2 for fairly little, number 3 for average, number 4 for fairly much, and number 5 for much.. The intent is, first, to select four of the twenty alternatives that are given number 5 and, second, four that are given number 4, etc. At the end, there will be four alternatives remaining that are given number 1, i.e., the ones that least influence selection.

investment criteria					
.2 level of target company management	1	2	3	4	5
.3 expected rate of return on invested capital	1	2	3	4	5
.4 level of risk related to the investment	1	2	3	4	5
.5 ownership stake being offered (<50%<)	1	2	3	4	5
.6 expected annual dividend income	1	2	3	4	5
.7 capital structure of the target company	1	2	3	4	5
.8 control to-be achieved over the target firn	1	2	3	4	5
.9 fiscal benefits	1	2	3	4	5
.10 product of the target company	1	2	3	4	5
.11 markets of the product	1	2	3	4	5
.12 marketing skills	1	2	3	4	5
.13 financial skills	1	2	3	4	5
.14 planning skills	1	2	3	4	5
.15 recommendations	1	2	3	4	5
.16 other parties to the transaction	1	2	3	4	5
.17 hometown of the target company	1	2	3	4	5
.18 height of market entry barriers	1	2	3	4	5
.19 size of required investment	1	2	3	4	5
.20 potential to create entrepreneurial culture	1	2	3	4	5
.21 industry (sector) of the target company	1	2	3	4	5

Who influence on the investment criteria					
.22 owners of the venture capital company	1	2	3	4	5
.23 board of directors	1	2	3	4	5
.24 management team	1	2	3	4	5
.25 president	1	2	3	4	5
.26 e.g., investment director, or other, what: ________________	1	2	3	4	5

Selection is made by					
.27 owners of the venture capital company	1	2	3	4	5
.28 board of directors	1	2	3	4	5
.29 management team	1	2	3	4	5
.30 president	1	2	3	4	5
.31 e.g., investment director, or other, what: ________________	1	2	3	4	5

Next, arguments concerning your portfolio companies. Pick number 1 when you fully disagree, etc., and number 5 when you fully agree.

.32 your participations in portfolio companies are always minority ownership positions	1	2	3	4	5
.33 your portfolio companies are always companies that are in the growth stage	1	2	3	4	5
.34 the president of a portfolio company is always a shareholder of his firm	1	2	3	4	5
.35 your primary income is annual by nature, such as dividends and management fees	1	2	3	4	5

General claims on operation modes of venture capital companies.

.36 most venture capital companies avoid start-up firms searching for more "made" firms	1	2	3	4	5
.37 most venture capital companies mainly pursue majority ownership positions	1	2	3	4	5
.38 the portfolio firm of a venture capital company should be entrepreneur-driven	1	2	3	4	5

3.2 DEVELOPMENT WORK BY THE VENTURE CAPITAL COMPANY: VALUE-ADDING

Value-adding can be divided into material and managerial value-adding

.1 What is the make-up of the material value-adding your company provides to your portfolio companies:

____

____

.2 How about the managerial value-adding:

____

____

Please indicate your opinion. Number 1 stands for little... and number 5 for a lot (a scale of 1-5).

Participation of your venture capital company in the business affairs of the portfolio firm					
.3 representative of the venture capital company to portfolio firm's personnel	1	2	3	4	5
.4 your own representative (if "not internally available") placed as the entrepreneur	1	2	3	4	5
.5 advising the portfolio company toward a consulting fee	1	2	3	4	5
.6 advising the portfolio company without charging any fees	1	2	3	4	5
.7 advising based on your own initiative and resulting from your innovative thought	1	2	3	4	5
.8 advising when requested	1	2	3	4	5
.9 passive	1	2	3	4	5

Arguments concerning venture capitalism. Number 1 stands for fully disagree... number 5 for fully agree.

.10	Active, "hands-on" venture capitalism is not generally mastered in Finland – there are no human resources for the job	1	2	3	4	5
.11	there is no need to master the job	1	2	3	4	5
.12	so called managerial value-adding does not take place inside the portfolio companies in Finland – only outside them	1	2	3	4	5
.13	in Finland, venture capital companies primarily add value to themselves	1	2	3	4	5
.14	or then their portfolio companies compromising their own development	1	2	3	4	5
.15	in Finland, not enough attention is pais to creating an entrepreneurial culture inside the portfolio company	1	2	3	4	5

Question regarding the structure of operations of your venture capital company. Each of the five numbers is given only once. They now stand for the following: number 1 stands for least time... number 5 stands for most time.

The operation of your venture capital company consists of the following

.16	development of the venture capital company's own strategy	1	2	3	4	5
.17	search for new portfolio companies	1	2	3	4	5
.18	development of existing portfolio firms	1	2	3	4	5
.19	exit efforts of existing portfolio companies	1	2	3	4	5
.20	other activity	1	2	3	4	5

3.2 FULFILLING THE VENTURE CAPITAL COMPANY'S PROFITING OBJECTIVE

.1 How does your company fulfil its profiting objective:

____

____

Next, please comment arguments when number 1 stands for fully disagree... and number 5 for fully agree.

.2	fiscal policy renewal 1989 will weaken venture capital companies' possibilities	1	2	3	4	5
.3	fiscal policy renewal 1989 will weaken *venture* -type "kehitysyhtiö" possibilities	1	2	3	4	5
.4	Finnish "kehitysyhtiö" firms have not been in venture -type business since 1980	1	2	3	4	5
.5	... since 1983	1	2	3	4	5
.5	... since 1985	1	2	3	4	5
.5	... since 1988	1	2	3	4	5

Next, questions regarding the final stage of the venture capital process, namely exiting.

.8 How many portfolio companies have exited by 1988:

____

____

.9 How have you been able to utilise public listing of portfolio company shares (e.g., on the OTC list) in exiting situations, and how would you project the potential to develop in this regard:

____

____

PART 4: FINALLY

.1 Name of respondent: _______________

.2 Position in venture capital company: _______________

.3 Phonenumber at work: _______________

Next, I ask you for information regarding corporate income.

.4 Income (sales) of the parent company: _______________

.5 Income (sales) of the conglomerate (parent plus portfolio companies of which over 50% stakes are held): _______________

.6 Income (sales) of the conglomerate plus portfolio (conglomerate plus companies of which, e.g., 10-50% or IAS based 20-50% are being held): _______________

.7 The ownership (%) amount that your answer to question 6 was based on: _______________

Next, I ask you to ponder upon the nature of your "kehitysyhtiö" (e. venture capital company).

.8 At the end of the day, is your company a "kehitysyhtiö" and, if it is, is it a *venture* or *development* type, or another type altogether:

____

____

Finally, I ask for your opinion on this research and venture capital research in general.

.9 Are there substantial issues related to venture capitalism that were not addressed in this survey at all or enough:

____

____

.10 What do you think about the need for venture capital research and what goals should be served by such:

____

____

.11 Are you available for an interview in my PhD study stage:

____

APPENDIX 4

SURVEY QUESTIONNAIRE 1992

1. YOUR BACKGROUND

1. How do you consider yourself as a venture capitalist relative to the general emphasis of your VC firm as a whole? (Please rank each status from 1 to 5: 5=most appropriate, 1=least appropriate. Mark each rank only once.)

yourself	your VC firm as a whole
____ a. Entrepreneur	____ a. Entrepreneurs
____ b. Professional Owner	____ b. Professional Owners
____ c. Financier	____ c. Financiers
____ d. Professional Manager	____ d. Professional Managers
____ e. Consultant	____ e. Consultants

2. Your experience working in the VC industry. (Please check one.)
___ a. This firm is my first experience working in the VC industry
___ b. I have previous VC experience but not at this senior level
___ c. I have previous VC experience also from the senior level
d. Your total experience in the VC industry: _____ Years
e. Year of foundation of your current VC company: 19_____

3. Which of the following two descriptions better describes your VC company? (Please check one.)

____ a. My VC firm is a partnership, the general partner of a fund structure in which the limited partners have limited voting power

____ b. My VC firm is a corporation in which the risk investors are shareholders (the funds are not separated from the VC management)

4. Funds under management. Please indicate the risk capital amounts and years of additional VC Funds (or of additional issues of stock, if funds not separated from the VC management company)

	amount raised ($ millions)	year
a. 1st fund or issue	__________	19____
b. 2nd fund or issue	__________	19____
c. 3rd fund or issue	__________	19____
d. 4th fund or issue	__________	19____
e. 5th fund or issue	__________	19____

2. STRATEGIC CONTEXT

1. Stage of the VC industry. Please check the one description that best expresses how you perceive the current stage of the VC industry in your country.
___ **Introductory Stage**. Demand for the major product is just starting to grow: products still unfamiliar to many potential users.
___ **Growth Stage**. Demand is growing at 20 % or more in real terms: infrastucture and competitive environment still changing.
___ **Shakeout Stage**. Industry capacity is beginning to exceed demand: standards are being established, weak firms driven out.
___ **Maturity Stage**. There is marginal or no growth in total demand: products are familiar to the majority of prospective users; infrastucture and competitive environment reasonably stable.
___ **Decline Stage**. Demand is declining for the industry as a whole; weaker competitors are beginning to exit.

2. Stage of your VC company. Please check the one description that best expresses how you perceive the current stage of your company.
___ **Start-up Stage**. You are in the process of raising your first fund and initializing the targeting phase. No deals closed as of yet.
___ **First Stage**. You have raised the first fund, and have a growing portfolio, but still capital for new target firms.
___ **Expansion Stage**. Your first portfolio is full and entering the harvesting stage. Additional funds being set up.
___ **Maturity Stage**. Several funds under management. Raising new funds and exiting have become key areas.
___ **Decline Stage**. You have reached the maximum in the number of funds, have full portfolios, and exiting is now the prime objective.

3. Your level of innovation. For each of the VC process functions, please indicate the degree to which your company attempts major innovation relative to industry practices:

	degree of innovation relative to competitors				
	low				**high**
a. Fund raising strategies and procedures	1	2	3	4	5
b. Targeting strategies and procedures	1	2	3	4	5
c. Structuring the deals	1	2	3	4	5
d. Strategies to add value to the target firms	1	2	3	4	5
e. Harvesting strategies for the value added	1	2	3	4	5

4. In terms of the VC process, please indicate the portion of time and effort consumed by each function in your VC firm, and rate their overall relative importance for your firm the way you perceive them:

Percentage of total	**least**		**important**		**most**
_____% a. Fund raising	1	2	3	4	5
_____% b. Targeting	1	2	3	4	5
_____% c. Deal structuring	1	2	3	4	5
_____% d. Value adding	1	2	3	4	5
_____% e. Harvesting	1	2	3	4	5
100 % Total					

5. Products of your VC firm.
a. Which of the following were considered as products of your VC company at the time of the foundation and how important they were relative to each other? (Please check all that are appropriate and rate their importance.)

	least		**important**		**most**
____ a. Capital	1	2	3	4	5
____ b. Value adding	1	2	3	4	5
____ c. VC management	1	2	3	4	5
____ d. Target companies	1	2	3	4	5
____ e. Other; specify ________________	1	2	3	4	5

b. Which of the following are currently considered as the products of your VC company and how important they are relative to each other? (Please check all that are appropriate and rate their importance.)

	least		**important**		**most**
____ a. Capital	1	2	3	4	5
____ b. Value adding	1	2	3	4	5
____ c. VC management	1	2	3	4	5
____ d. Target companies	1	2	3	4	5
____ e. Other; specify ________________	1	2	3	4	5

6. Market for the products of your VC firm.

a. Which of the following were considered as the markets (customers) of your VC company at the time of the foundation and how important they were relative to each other? (Please check all that are appropriate and rate their importance.)

	least	important			most
____ a. Risk investors	1	2	3	4	5
____ b. Target entrepreneurs	1	2	3	4	5
____ c. Final investors	1	2	3	4	5
____ d. Government	1	2	3	4	5
____ e. Other; specify ________________	1	2	3	4	5

b. Which of the following are currently considered as the markets (customers) of your VC company and how important they are relative to each other? (Please check all that are appropriate and rate their importance.)

	least	important			most
____ a. Risk investors	1	2	3	4	5
____ b. Target entrepreneurs	1	2	3	4	5
____ c. Final investors	1	2	3	4	5
____ d. Government	1	2	3	4	5
____ e. Other; specify ________________	1	2	3	4	5

7. Organization of your VC firm. In this question, General Partners and Directors are refered to as Senior Management, and Associates and Managers as Junior Management.

a. The average number of employees in your VC firm (including yourself):

	at foundation	today
- senior management	________	________
- junior management	________	________
- support staff	________	________

b. Employees' voting rights as percentage of total in your VC company:

	at foundation	today
- senior management	______ %	______ %
- junior management	______ %	______ %
- support staff	______ %	______ %

8. Is your VC management firm marketed to potential risk investors?

____ Yes ____ No

a. If Yes, how: ________________________________

____

b. If No, why not? ______________________________

____

9. Please comment on the following statements.

	disagree	fully			agree
a. Marketing the VC mgmt team to potential risk investors is as important to your business as any marketing of a product is to any business	1	2	3	4	5
b. The trend in the VC industry is from active to passive fund raising strategy	1	2	3	4	5
c. "Packaging" the VC management team as a product is becoming more sophisticated and meaningful for you when raising capital	1	2	3	4	5

10. Please indicate your opinion on the importance of the characteristics of "true" VC activity: what is important for a business to be called a VC firm? (Please indicate relative importance of the characteristics.)

	least	important			most
a. VC management team's control of the funds over the risk investors	1	2	3	4	5
b. Equity investments: to buy and to sell equity interests to materialize capital gains	1	2	3	4	5
c. Certain qualities of the target firms (they have to be, e.g., start-ups, high tech, etc.)	1	2	3	4	5
c. High risk. Risk associated with investment is related to a practically untested innovation	1	2	3	4	5
e. The purpose should be simply to make money. Enhancing the economic growth of a nation or the strategic interests of risk investors should be no more than side effects	1	2	3	4	5

11. Rate the influence of the risk investors on the strategic decisions of the VC firm at the following levels.

	no	importance			great
a. Mission and purpose	1	2	3	4	5
b. General strategy	1	2	3	4	5
c. Targeting criteria	1	2	3	4	5
d. Selection	1	2	3	4	5
e. Deal structuring	1	2	3	4	5
f. Value adding	1	2	3	4	5
g. Harvesting	1	2	3	4	5

3. TARGETING

1. What is the origin of the closed deals: where do your leads come from? Please rank the importance of the following alternatives

	no	importance			great
a. Recommendations of other VC firms	1	2	3	4	5
b. Participation to a syndicated deal as a passive investor	1	2	3	4	5
c. Recommendation from outside the VC community	1	2	3	4	5
d. Your own active search for promising targets	1	2	3	4	5
e. Approach by the entrepreneur or other owners of a target company	1	2	3	4	5
f. Approach by the target company management	1	2	3	4	5

2. Based on your best estimate, please indicate the following deal generation figures of your VC firm.

	a. Number of business plans offered to your VC firm	b. Number of targets having entered the due diligence process	c. Number of closed deals
1987	______	______	______
1988	______	______	______
1989	______	______	______
1990	______	______	______
1991	______	______	______

3. Rate the sectors of economy and the target firm development stages in terms of preferences of your VC firm. (Please use a 1 to 5 scale: 1 = no interest, 5 = great interest)

a. Sector of economy.
____ Manufacturing
____ Wholesale
____ Retail
____ Service
____ Financial
____ Computer software
____ Computer hardware
____ Gene & biotech

b. Stage
____ Seed
____ Start-up
____ First stage
____ Expansion
____ Mezzanine
____ Buyout

4. Targeting criteria. How does the criteria differ by content and importance between the initial screening phase and the due diligence phase? (Concerning both phases please rate every criteria in importance with a 0-100 scale.)

initial screening phase rate from 0-100	THE TARGETING CRITERIA	*due diligence phase* rate from 0-100
______	General ability of the target firm mgmt	______
______	Mgmt's marketing skills	______
______	Mgmt's financial skills	______
______	High entrepreneurial culture	______
______	Low level of business risk	______
______	Expected return on investment	______
______	Timing until 1st cash out	______
______	Expected annual cash out	______
______	Timing until final exit	______
______	Social responsibilty of the target firm	______
______	Target company industry	______
______	Target firm's product	______
______	Market of target's product	______
______	Target's development stage	______
______	Target's geographical location	______
______	Other participants of deal	______
______	Size of share of ownership	______
______	Control over the target mgmt	______
______	Target's capital structure	______
______	Tax planning aspects	______
______	Target's ability to finance itself	______
______	Size of required investment	______

5. Who makes the decisions in each targeting phase? (Please rank the groups in relative importance)

initial screening phase no influence great		*due diligence phase* no influence great
1 2 3 4 5	Risk investors	1 2 3 4 5
1 2 3 4 5	Board of directors	1 2 3 4 5
1 2 3 4 5	Senior VC mgmt	1 2 3 4 5
1 2 3 4 5	Junior VC mgmt	1 2 3 4 5
1 2 3 4 5	Head of the VC firm	1 2 3 4 5
1 2 3 4 5	Another one manager	1 2 3 4 5
1 2 3 4 5	Other:__________	1 2 3 4 5

6. To what extent does your VC firm rely on outside investment advice? What sources do you use when considering to buy or to sell interests in target companies and how important they are to you? (Please check only the sources your VC firm uses and then indicate how important you think these sources are.)

when buying interests least important most		*when selling interests* least important most
1 2 3 4 5	Banks	1 2 3 4 5
1 2 3 4 5	M&A brokers	1 2 3 4 5
1 2 3 4 5	Outside, independent investment consultants	1 2 3 4 5
1 2 3 4 5	Other VC firms	1 2 3 4 5
1 2 3 4 5	Investment banks	1 2 3 4 5
1 2 3 4 5	Academicians	1 2 3 4 5
1 2 3 4 5	Other (what) ______	1 2 3 4 5

7. Is your VC management firm marketed to the potential target firms?

____ Yes ____ No

a. If Yes, how: ______________________________

____

b. If No, why not? ____________________________

____

8. Please comment on the following claims:

	disagree fully agree
a. Marketing the VC mgmt team to potential target firms is as important to your business as any marketing of a product is to any business.	1 2 3 4 5
b. The trend in the VC industry is from active to passive targeting strategy.	1 2 3 4 5
c. "Packaging" the VC management team as a product is becoming more sophisticated and meaningful in your targeting strategy.	1 2 3 4 5

4. STRUCTURING

1. Please indicate the importance of the following tasks to your VC firm.

	no importance great
a. To better the relationship between the target firm profit and the equivalent shareholder value?	1 2 3 4 5
b. To minimize the misalignment of interest between your VC firm and the target management in the deal structuring phase of the VC process	1 2 3 4 5
c. To monitor the activities of a target mgmt after structuring the deal to assure that it benefits you as an owner?	1 2 3 4 5

2. What measures, if any, does your VC firm take in order to minimize the misalignment of interest between your VC firm and the management of the target firm? (check all appropriate alternatives):

____ a. We accomplish this by tying target management salaries and benefits to the goals of our VC firm.

____ b. We allow, but do not demand that the target's management, and even the employees hold portion of the target firm's equity.

____ c. We demand that the target's management, and even the employees hold portion of the target firm's equity.

____ d. We make both contractual agreements with the target's management about salaries and benefits, as well as demanding that they own certain share of the firm's equity.

____ e. We don't take any measures of this kind into consideration.

____ f. Other mearsures taken. Please specify: ____________

____

3. Majority or minority position. How important is the control over the target firms for your strategy? (Please, based on your best estimate, indicate as % of total number of deals how much your VC firm has used each ownership structure)

____ % a. My VC firm holds directly over 50 % of votes in the shareholders meeting and in the Board.

____ % b. My VC firm holds, through syndication, over 50 % of votes in the shareholders meeting and in the Board.

____ % c. My VC firm has the option to gain direct control through covenants, warrants and option plans that are tied to the success of the target management.

____ % d. My VC firm has, through syndication, the option to gain control through covenants, warrants and option plans that are tied to the success of the target mgmt.

____ % e. My VC firm has a definite effective minority position: no options to gain control at any circumstances.

100 % Total

4. What kind of owner structures do you enter? (Please, based on your best estimate, indicate the proportion as % of total each situation covers of all owner structures of your target firms.)

____ % a. Entrepreneurs and other active persons as partners and co-owners in a target firm situation.

____ % b. Closely held and other private small companies as partners and co-owners in a target firm situation.

____ % c. Publicly held and other large companies as partners and co-owners in a target firm situation.

____ % d. State and/or county companies and/or organization as partners and co-owners in a target firm situation.

____ % e. Other VC firms as partners and co-owners in a target firm situation.

____ % f. Passive investors as co-owners in a target firm situation.

100 % Total

5. Who starts as target firm management? (Please, based on your best estimate, indicate the proportion as % of total each situation covers of all the entries of your VC firm.)

____ % a. Old management continues with a majority ownership stake (above 50 %) of the target company.

____ % b. Old management continues with a strong ownership stake (20-50 %) of the target company.

____ % c. Old management continues either without ownership or with a minor stake (below 20 %) of target company.

____ % d. New management enters with a majority ownership stake (above 50 %) of the target company.

____ % e. New management enters with a strong ownership stake (20-50 %) of the target company.

____ % f. New management enters either without ownership or with a minor stake (below 20 %) of target company.

100 % Total

5. ADDING VALUE

1. Please carefully check the objective that best describes the position of your VC firm in regard to value adding:

____ a. We want to add value to our holdings in our target firms any way we can. Deep down we are just buying and selling interests in companies in efforts to make the most money out of it. If the target firms make a future out of our efforts, there is no harm done.

____ b. We want to add value to the target firms in order for them to make it far into the future. Deep down we are in this business to build businesses, to add to their well being. If we make money on the side, there is no harm done.

____ c. We want to pass idea and innovation to our risk investors. To us value adding is above all value adding to the strategic capabilities of our risk investors. If the target firms make a future out of our efforts and if we make money on the side, no harm done.

2. This question seeks to understand how much importance your VC firm places on the various roles your firm might have taken with regard to the management teams of the target firms and how satisfied you are with the results of the efforts in each of these roles. (Please indicate on the left side below how important you think this role is for your VC firm and then rate on a scale from one to ten (10 = most effective) how effective you think your firm's efforts have been):

no importance **great**	DIFFRERENT ROLES	effectiveness on **scale from 1-10**
1 2 3 4 5	FINANCIER: You provide or arrange timely funding	_____
1 2 3 4 5	SOURCE OF PROFESSIONAL CONTACTS: You know or can locate lawyers, consultants, etc.	_____
1 2 3 4 5	SOURCE OF INDUSTRY CONTACTS: You help generate orders, reach licensing or lease agreements, etc.	_____
1 2 3 4 5	BUSINESS CONSULTANT: You discusses plans, review targets, offer feedback, provide management assistance, etc.	_____
1 2 3 4 5	MANAGEMENT RECRUITER: You help locate key members for the management team.	_____
1 2 3 4 5	SOUNDING BOARD: You listen to problems, respond objectively, frankly, truthfully.	_____
1 2 3 4 5	COACH/MENTOR: You provide encouragement, positive reinforcement, support and motivation.	_____
1 2 3 4 5	FRIEND/CONFIDANT: You are concerned for the target firm's CEO as a person, and will go out of your way for him/her.	_____
1 2 3 4 5	OTHER: ______________ ____________________	_____

3. How regularly does your VC firm on average interact with the management of a target firm? (Please check one on each line)

a. During the first two years of your VC firm presence.

	Every day	Once a week	Twice a month	Once a month	Once a quarter	Less Often
Face-to-face	___	___	___	___	___	___
By telephone	___	___	___	___	___	___
In writing	___	___	___	___	___	___

b. During the time after two years of your VC firm ownership.

	Every day	Once a week	Twice a month	Once a month	Once a quarter	Less Often
Face-to-face	___	___	___	___	___	___
By telephone	___	___	___	___	___	___
In writing	___	___	___	___	___	___

4. How do you think your VC firm contributes to the management of your target firms?

	no	influence			great
a. General management of daily operations	1	2	3	4	5
b. Financial management	1	2	3	4	5
c. Production management	1	2	3	4	5
d. Research and development	1	2	3	4	5
e. Marketing and sales	1	2	3	4	5
f. Strategic planning	1	2	3	4	5
g. Monitoring shareholder value	1	2	3	4	5

5. Please indicate your opinion on the nature of the kind of value adding that makes a business VC business. Check the most appropriate description of value adding. (Please study the options very carefully)

____ a. It is simple. Value adding refers to any increase in the value of the VC firm's ownership interest in a target firm after the deal is closed. Sometimes mere passive presence of a VC firm sends such a positive signal to the market that it alone adds value.

____ b. Passive presence is never value adding, even if the VC firm interest grows tenfold in value after the deal is structured. Active ownership is required for it to be value adding: at least some reallocation of target's resources or restructuring of assets have to take place on the VC firm's initiative.

____ c. The above refers to just "fixing of the financials" and not to any VC business at all. "True" value adding should involve active managerial input, at least on the level of strategic planning.

____ d. VC is about building businesses, thus none of the above are enough. One has to work down on the floor with the target firm management and assist them with all the different functions of firm (production, finance, marketing, administration). Only the increase of value of VC firm interest that is based on this kind of engagement can be called value adding and thus venture capital.

7. HARVESTING

In this chapter, the word exit refers to the system to capitalize the interests in your target firms that is the cash out mechanism of your VC firm. At an extreme also dividends can be seen as an exit avenue.

1. Timing.

a. Does your VC firm have a pre-set target time to exit you target firms? ____ Yes ____ No

b. If Yes, then how many years is the prefered exit? ____ Years

c. Of all the exits of your VC firm what has been the average time of your participation? ____ Years

2. Please indicate your best estimate on who have purchased what proportion of your target firms: What is the proportion of each group of (a) the total cash out, (b) the total number of exits of your VC firm?

	as % of total cash out	as % of total number of exits
a. Corporative buyers (large firms)	____ %	____ %
b. Entrepreneurs and small firms	____ %	____ %
c. Target firm management	____ %	____ %
d. State or county organizations	____ %	____ %
e. Other VC funds	____ %	____ %
f. Risk investors of own fund	____ %	____ %
g. Investors thru stock market	____ %	____ %
h. Liquidation of assets	____ %	____ %
i. Quiting business	____ %	____ %
j. Bankruptcy	____ %	____ %
k. Other ____________	____ %	____ %
____________	100 % Total	100 % Total

4. Are your target firms marketed to the potential final investors?

____ Yes ____ No

a. If Yes, how: ______________________________

____

b. If No, why not? ______________________________

____

5. Please comment on the following statements:

	disagree	fully			agree
a. Marketing your target firms to the potential final investors is as important to your business as any marketing of a product is to any business.	1	2	3	4	5
b. The trend in the VC industry is from passive to active harvesting strategy	1	2	3	4	5
c. "Packaging" of target firms as products is becoming more sophisticated and meaningful in your harvesting strategy.	1	2	3	4	5

7. Please rank the following marketing tasks in importance for your VC process the way you perceive them. (Please give each a different rank)

	least	important			most
a. Marketing the VC mgmt to the risk investors	1	2	3	4	5
b. Marketing the VC mgmt to the target firms	1	2	3	4	5
c. Marketing the target firms to final investors	1	2	3	4	5

8. Can you think of other marketing tasks of your VC company?

____ Yes ____ No

a. If Yes, what tasks? ______________________________

____

____

b. Do these tasks exceed 7a, 7b, and 7c from above in importance?

____ Yes ____ No

2. OWNERSHIP AND CONTROL

Questions 1 and 2 are based on the following group categories.

a. Private, independent businessmen/women in a partnership situation: venture capital management itself, who then raised the capital from the risk investor market

b. Privately held or other private small companies (owned by individuals or other small firms): risk investors themselves, who then selected the venture capital management team

c. Publicly held or other large (non-state/non-county owned) corporations: risk investors themselves, who then selected the venture capital management team

d. State owned and controlled companies, organizations, and/or institutions

e. Companies, organizations, and/or institutions owned and controlled by counties

f. Ownership so dispersed that no one unanimous group can be pointed out

1. Please express your opinion based on the group categories above. (Check one in each line.)

a. On which group's initiative was the VC firm established?	a	b	c	d	e	f
b. After the foundation, which of the groups had the control over the strategic decisions in your VC firm?	a	b	c	d	e	f
c. Currently, which of the groups has the control over the strategic decisions in your VC firm?	a	b	c	d	e	f

2. Please first check all the groups that currently own your VC firm and then indicate their voting rights as % of total voting rights.

Voting Rights as % of total

I Private
____ a. Experienced entrepreneurs ____ %
____ b. Professional managers ____ %
____ c. Other individual persons ____ %
____ d. Small companies held by persons ____ %
II Corporate (non-state)
____ e. Publicly held companies ____ %
____ f. Other large companies ____ %
____ g. Other companies not held by persons ____ %
____ h. Banks and incurance companies ____ %
III Communal ("state or county owned")
____ i. State companies and other organizations ____ %
____ j. Home county organizations ____ %
____ k. Organizations of other counties ____ %
IV Other
____ l. Pension funds ____ %
____ m. Other private foundations ____ %
____ n. Universities and research centers ____ %
____ o. Foreign sources ____ %
____ p. Other: ________________ ____ %
100 % Total

3. How is the senior strategic decision making body of your VC firm composed? (Refered to here as the Board.)
a. What is the size of your Board? ____ Total members
b. Of which VC firm professionals: ____ Professionals
c. Of which risk investors: ____ Risk Investors
d. Of which from outside VC structure: ____ Outsiders

4. How does the Board of your VC firm decide on key issues? (Please check the most appropriate in both 4a and 4b.)

a. According to:
____ A simple majority.
____ A consensus.
____ A unanimous vote.

b. Based on:
____ One vote per person.
____ The respective voting rights of the VC firm each Director represents.
____ The respective share of risk capital investment each Director represents.

c. In another way. Please explain: ____________________

____

Questions 6 and 7 are based on the following categories on the purpose of your VC firm.

a. To target specific new industries or promising technologies which compliment some overall strategic business purpose of risk investor.
b. To buy, to add value to, and to sell interests in target companies (without industry preference of risk investor) simply in order to achieve high monetary returns
c. To enhance the economic growth of your nation or some of its local regions.

6. Which category best describes the purpose of your VC company

a. Purpose in the foundation	a	b	c
b. Purpose currently (1992)	a	b	c

7. If your answers to 6a and 6b are different, please indicate the year(s) of change and the new purpose.

	year of change in purpose	new purpose		
a. First change	19____	a	b	c
b. Second change	19____	a	b	c
c. Third change	19____	a	b	c

8. How important are the following objectives to your VC firm today? (Please rate relative importance)

	least	important			most
a. To provide a safe return to your investors	1	2	3	4	5
b. To be socially responsible in the investment strategy	1	2	3	4	5
c. To provide the highest possible return to your venture capital management company	1	2	3	4	5
d. To achieve objectives other than direct monetary returns on investment	1	2	3	4	5

THANK YOU

THANK YOU FOR YOUR COOPERATION

If you are interested in discussing this study further please check here:

__ Yes. Please contact me:

Your name: ____________________
Company name: ____________________
Telephone: ____________________
Telefax: ____________________

As stated in the survey cover, we would be pleased to send you a copy of the results of the study. If you are interested, please either indicate your address below or send us a separate request in case you do not wish to state your exact coordinates.

Address: ______________________________

APPENDIX 5

SURVEY QUESTIONNAIRE 1997

TRANSLATION FROM FINNISH TO ENGLISH (As the questionnaire was constructed and processed in Finnish only, this translation is provided for information purposes only. Sections 2, 3, and 4 of the questionnaire were not utilised for the purposes of the present analysis.)

1. BACKGROUND INFORMATION

1. Name of the venture capital company: ____________________
2. When was the company launched (month/year): ____________________
3. Company management comprises of: ______ persons.
4. Management's industry experience is, in total: ______ years.

5. OWNERS, STRUCTURE, AND MISSION

Questions 1 and 2 are based on the following owner categories:

mgmt Managers of the venture capital company (management)
inv Private sector companies and institutions (investors)
govt Public sector companies and institutions (government)

1. Your company's main owner (the one in control) at different times (pick one alternative on every row, even if answer remains the same)

	mgmt	inv	govt
(a) Initiator to establish the company	___	___	___
(b) Main owner during first years	___	___	___
(c) One preceding current main owner	___	___	___
(d) Current main owner	___	___	___
(e) Future main owner?	___	___	___

2. Owner groups' proportion of voting rights in your venture capital company at different times (answer row by row, date and mark major changes in ownership, if any, pursuing an accuracy of ca. 5%)

Change: month/year	mgmt	inv	govt	total
(a) At foundation	___%	___%	___%	= 100%
(b) Change: ___/ 19___	___%	___%	___%	= 100%
(c) Change: ___/ 19___	___%	___%	___%	= 100%
(d) Currently	___%	___%	___%	= 100%
(e) In the future?	___%	___%	___%	= 100%

3. Which of the following better describes your company structure?

____ (a) My firm is a management company that manages separate venture capital fund vehicles (makes no investments itself)

____ (b) My firm makes the venture capital investments itself (management activity is not incorporated under different ownership)

4. Funds under management by your company (MFIM) in total:

(a) Shareholders' equity of your venture capital company MFIM _______
(b) Total capital invested into your fund vehicles or stock issues by investors MFIM _______
(c) Total assets of all of your portfolio companies combined (estimate): MFIM _______

The next questions is based on the following classification of missions in venture capital activity:

I Invest in industries and technologies that enhance the own business interests of the venture capital company's funders
II Invest based on own terms, add value, and finally sell to highest bidder – aiming at maximal direct financial gain
III Invest in businesses that employ and industrialise, i.e., enhance regional or national economic progress

5. Your venture capital company's mission at different times (pick the most suitable alternative on every row; answer every row, even if the answer remains the same)

	mission		
(a) Founding mission	I	II	III
(b) Mission during first years of activity	I	II	III
(c) Mission preceding the current mission	I	II	III
(d) Current mission	I	II	III
(e) Mission in the future (your estimate)?	I	II	III

6. Please comment the following arguments

	disagree				agree
(a) Venture capitalism should be based on entrepreneurship: responsibility and power concerning decisions belong to management – funders' role should be limited to monitoring	1	2	3	4	5
(b) Key members of venture capital company personnel may own some equity in the firm (as partners), but investment decisions belong to funders	1	2	3	4	5

6. VENTURE CAPITAL PROCESS

1. Who is the customer of your venture capital company ("which demand do you primarily supply for in the economy")?
____
____

2. What is the product of your venture capital company ("which supply, in the economy, do you primarily represent")?
____
____

3. Estimate the relative influence of your funders to your company's decision making at different stages (rank from 1 to 5: number 1 stands for biggest influence, number 2 for second biggest, etc., and number 5 stands for the smallest influence; do not give the same number twice):

___ (a) Mission of operations and general strategy
___ (b) Setting up and raising capital for new fund vehicles
___ (c) Investment criteria for portfolio company investments
___ (d) Actual investment decisions
___ (e) Value adding (post investment) activity
___ (f) Exiting from investments

4. Evolution of your target market (answer column per column by marking your target market at the time indicated by the column)

Target market	point of time: first years	these days	estimate of future
(a) Hometown region (widely)	___	___	___
(b) Rest of Finland	___	___	___
(c) Rest of the European Union	___	___	___
(d) Russia	___	___	___
(e) Baltics (Estonia, Latvia, Lithuania)	___	___	___
(f) Rest of Eastern Europe	___	___	___
(g) Rest of the world	___	___	___

5. Who makes the decisions in the different stages of the process (pick only one group in each column)?

	investment criteria	entering decisions	exiting decisions
(a) Representatives of funders	___	___	___
(b) Representatives of management	___	___	___
(c) Outside specialists	___	___	___

6. Which groups do you refer to when considering to buy or sell interests in portfolio companies.? How important are the reference groups when compared with each other (on a scale from 1-5; number 1 stands for not important, number 5 for very important)?

when buying interests not important most		*when selling interests* not important most
1 2 3 4 5	Your own funders	1 2 3 4 5
1 2 3 4 5	Lawyers, auditors	1 2 3 4 5
1 2 3 4 5	Other VC companies	1 2 3 4 5
1 2 3 4 5	Banks and insurers	1 2 3 4 5
1 2 3 4 5	Financial advisers	1 2 3 4 5
1 2 3 4 5	Dating/data services	1 2 3 4 5
1 2 3 4 5	Other (what) ______ ______________	1 2 3 4 5

7. Which of the following best describes your company's attitude towards value-adding activity?

____ a. We want to add value to our holdings in our target firms any way we can (we sell to the highest bidder). If the target firms make a future out of our efforts, there is no harm done.

____ b. We want to secure the future of our portfolio companies (we build businesses). If we (and hence our funders) make money on the side, there is no harm done.

____ c. We want to pass idea and innovation to our funders (we are innovation intermediaries). If we ourselves or our portfolio companies benefit on the side, no harm done.

8. How does your company (on average) participate in business development inside your portfolio companies (number 0 stands for no influence, number 1 for minor influence, etc., and number 5 for major influence).

		no influence	minor				major
(a)	Production	0	1	2	3	4	5
(b)	R&D	0	1	2	3	4	5
(c)	Accounting and finance	0	1	2	3	4	5
(d)	Sales and marketing	0	1	2	3	4	5
(e)	Internationalisation	0	1	2	3	4	5
(f)	Strategic planning	0	1	2	3	4	5
(g)	Corporate governance	0	1	2	3	4	5

9. Exiting: Please indicate the proportions each exit avenue represents of total number of exits and total cash proceeds (in case all of your exits have materialised via the same avenue, you mark "100%" on both columns on the selected row)

	as % of total number of exits	as % of total cash proceeds
(a) Company mgmt (MBO/MBI)	____ %	____ %
(b) Own funders (trade sale)	____ %	____ %
(c) Outside acquirers (trade sale)	____ %	____ %
(d) Outside investors (IPO)	____ %	____ %
(e) Liquidation/bankruptcy	____ %	____ %
Total	100 % Total	100 %

10. What is the pecking order of the following marketing tasks in your company (give each alternative a different number; number 1 stands for the most important, number 2 for the second, and number 3 for the third most important task)?

___ (a) Marketing investment vehicles (such as funds) to potential investors ("funders").

___ (b) Marketing the funds and value-adding contribution to new investment targets ("suppliers").

___ (c) Marketing saleable portfolio companies to potential purchasers ("consumers")

11. Are there more important marketing tasks, in your company, than the three listed above?

Yes _____ No _____

If "yes", which taks?

____

____

FINALLY

Please rank the qualities of "the ideal venture capitalist" with a scale from 1-5 (number 1 stands for the most important quality, number 2 for the second, etc., and number 5 for the fifth most important quality; do not give the same number twice)?

The ideal venture capitalist:

___ (a) Marketing investment vehicles (such as funds) to potential investors ("funders").

___ (b) Marketing the funds and value-adding contribution to new investment targets ("suppliers").

___ (c) Marketing saleable portfolio companies to potential purchasers ("consumers").

___ (d) Marketing the funds and value-adding contribution to new investment targets ("suppliers").

___ (e) Marketing saleable portfolio companies to potential purchasers ("consumers").

THANK YOU

THANKING FOR YOUR CO-OPERATION

Indicate here, if you are interested in discussing and deepening your answers.

_____ Yes. Please contact me:

Name: ______________________

Telephone: ______________________

Telefax: ______________________

APPENDIX 6

TABLES RELATED TO CHAPTER 5 SURVEY ANALYSES

TABLE A Development stage of the local venture capital industry and the respondent's company (1992)

DEVELOPMENT STAGE OF THE VENTURE CAPITAL INDUSTRY/ COMPANY	*(Industry rated 1-2 for growth, 3 shakeout, 4-5* mature*)* *Company rated 1-2 for early, 3 growth, 4-5* mature*)* AMERICA Entrepreneurial Mean SD n	Corporate Mean SD n	FINLAND Corporate Mean SD n	SURVEY 1992 Governmental Mean SD n	*ANOVA P value*
Development stage of the venture capital *Industry*	**3.3** 1.04 35	**3.3** 0.87 9	**2.2** 1.31 14	**1.5** 0.71 10	*0.000****
	mature 29%	mature 33%	mature 14%	mature 0%	
	shakeout **57%**	shakeout **56%**	shakeout 7%	shakeout 10%	
	growth 14%	growth 11%	growth **79%**	growth **90%**	
Development stage of the venture capital *Company*	**3.2** 0.96 34	**3.4** 1.01 9	**2.9** 1.23 14	**1.9** 0.33 9	*0.003****
	mature **44%**	mature **56%**	mature 21%	mature 0%	
	growth 32%	growth 22%	growth 21%	growth 0%	
	early 24%	early 22%	early **57%**	early **100%**	

p < 0.100, p** < 0.050, p*** < 0.010, p*** < 0.001*

TABLE B Perception of oneself vs. the company (as a whole) as venture capitalists (1992)

PERCEPTION OF ONE-SELF AND THE FIRM AS VENTURE CAPITALISTS	(Rated 1-5: from least to most appropriate, 1 for least, 5 for most appropriate) Entrepreneurial AMERICA Rated	Mean	SD	n	Corporate AMERICA Importance	Mean	SD	n	Corporate FINLAND Importance	Mean	SD	n	SURVEY 1992 Governmental FINLAND Importance	Mean	SD	n	*ANOVA P value*
Respondent himself:																	
Entrepreneur	5 by 43% 1 by 10%	**3.80**	1.37	30	5 by 43% 1 by 0%	**3.71**	1.38	7	5 by 8% 1 by 15%	2.69	1.18	13	5 by 0% 1 by 0%	3.00	0.82	7	*0.058**
Financier	5 by 23% 1 by 16%	3.03	1.43	31	5 by 14% 1 by 0%	3.71	0.76	7	5 by 8% 1 by 23%	2.62	1.26	13	5 by 0% 1 by 0%	3.25	0.89	8	*0.315*
Professional manager	5 by 18% 1 by 18%	2.93	1.36	28	5 by 28% 1 by 25%	2.63	1.60	8	5 by 77% 1 by 8%	**4.46**	1.20	13	5 by 88% 1 by 0%	**4.88**	0.35	8	*0.000****
Professional owner	5 by 14% 1 by 28%	2.90	1.47	29	5 by 25% 1 by 38%	3.00	1.77	8	5 by 0% 1 by 31%	**2.15**	1.07	13	5 by 25% 1 by 63%	**2.25**	1.83	8	*0.364*
Consultant	5 by 25% 1 by 32%	**2.75**	1.62	28	5 by 14% 1 by 29%	**2.57**	1.51	7	5 by 8% 1 by 23%	3.15	1.41	13	5 by 13% 1 by 0%	3.12	1.13	8	*0.766*
Company as a whole:																	
Entrepreneurs	5 by 31% 1 by 7%	**3.59**	1.27	29	5 by 38% 1 by 25%	**3.50**	1.69	8	5 by 0% 1 by 46%	**1.92**	1.04	13	5 by 0% 1 by 13%	2.38	0.92	8	*0.001****
Professional owners	5 by 21% 1 by 24%	3.07	1.54	28	5 by 38% 1 by 38%	3.00	1.93	8	5 by 15% 1 by 15%	3.00	1.35	13	5 by 25% 1 by 63%	**2.38**	1.92	8	*0.754*
Financiers	5 by 31% 1 by 13%	3.28	1.44	32	5 by 0% 1 by 14%	3.00	1.15	7	5 by 38% 1 by 8%	**3.69**	1.38	13	5 by 25% 1 by 0%	3.63	1.06	8	*0.646*
Professional managers	5 by 24% 1 by 10%	3.10	1.35	29	5 by 14% 1 by 0%	3.00	1.15	7	5 by 31% 1 by 0%	3.62	1.12	13	5 by 13% 1 by 0%	**3.75**	0.89	8	*0.383*
Consultants	5 by 25% 1 by 39%	**2.71**	1.70	28	5 by 14% 1 by 29%	**2.43**	1.40	7	5 by 8% 1 by 31%	2.77	1.48	13	5 by 25% 1 by 0%	3.62	1.06	8	*0.435*

p < 0.100, p** < 0.050, p*** < 0.010, p*** < 0.001*

TABLE C Descriptive statistics on the characteristics of true venture capitalism (1992)

RELATIVE IMPORTANCE OF GIVEN ASPECTS ON WHAT IS TRUE VC	(rated 1-2 for minor, 3 for average, 4-5 for major) AMERICA Entrepreneurial Importance	%	n	Corporate %	n	FINLAND Corporate Importance	%	n	SURVEY 1992 Governmental %	n
Buying and selling equity interests for profit	major	**83%**	35	**78%**	9	major	**100%**	14	**70%**	10
	minor	3%		0%		minor	0%		10%	
Management's control of provided funds	major	**69%**	35	**78%**	9	major	**31%**	13	**70%**	10
	minor	14%		0%		minor	31%		20%	
Purpose to make money: No hidden agenda	major	**54%**	35	**38%**	8	major	**38%**	13	**40%**	10
	minor	20%		38%		minor	46%		40%	
Classic investee venture characteristics	major	**60%**	35	**50%**	8	major	**23%**	13	**50%**	10
	minor	17%		25%		minor	54%		40%	
High risk associated with the investment	major	**34%**	35	**38%**	8	major	**8%**	13	**10%**	10
	minor	34%		38%		minor	77%		70%	

TABLE D Governance related opinions (1989)

Statement 1: *"VC company personnel should include shareholders of the firm (i.e., partners)."*
Statement 2: *"It is important to create an entrepreneurial culture also inside the VC company."*
Statement 3: *"The role of the board of directors is greater in venture capitalism than in more 'conventional' business activity."*

POSITION REGARDING GIVEN STATEMENTS ON VC	(Rated 1-5: 1-2 disagree, 3 neutral, 4-5 agree) Corporate sample Position		Mean	SD	n	Governmental sample Position		Mean	SD	n	FINLAND 1989 *ANOVA P value*
Statement 1	agree	53%	**3.47**	1.50	19	agree	62%	**3.54**	1.33	13	*0.901*
	disagree	26%				disagree	15%				
Statement 2	agree	95%	**4.58**	0.92	19	agree	92%	**4.62**	1.12	13	*0.922*
	disagree	5%				disagree	8%				
Statement 3	agree	74%	**3.89**	0.81	19	agrees	77%	**4.00**	0.91	13	*0.734*
	disagree	5%				disagree	8%				

TABLE E Governance related opinions (1997)

Statement 1: *"Venture capitalism should be based on entrepreneurship: Responsibility and power concerning decisions belong to management – funders' role should be limited to monitoring"*

Statement 2: *"Key members of venture capital company personnel may own some equity in the firm (as partners) but investment decisions belong to funders"*

POSITION REGARDING GIVEN STATEMENTS ON VC	*(Rated 1-5: 1-2 disagree, 3 neutral, 4-5 agree)* Corporate Position		Mean	SD	n	Governmental Position		Mean	SD	n	FINLAND 1997 *ANOVA P value*
Statement 1	agree	63%	4.00	1.41	8	agree	70%	3.36	1.34	10	*0.651*
	disagree	25%				disagree	20%				
Statement 2	agree	50%	3.38	1.41	8	agree	55%	3.64	1.12	11	*0.658*
	disagree	25%				disagree	18%				

TABLE F Influence of owners on given issues that shape company policy (1989)

HOW DOES OWNER INFLUENCE ON COMPANY POLICY SHOW?	*(Rated 1-5. 1 for none, 2-3 for some, 4 5 for major influence)* FINLAND 1989 Corporate sample Influence		Mean *(rank)*	SD	n	Governmental sample Influence		Mean *(rank)*	SD	n	*ANOVA P value*
As requirements for more dividends?	major	50%	**3.50**	1.24	20	major	**8%**	1.75	0.97	12	*0.000****
	some	40%				some	42%				
	none	10%				none	50%				
As fostering of entrepreneurial ideals?	major	48%	**3.29**	1.31	21	major	54%	**3.54**	1.20	13	*0.576*
	some	38%				some	38%				
	none	14%				none	8%				
In the selection of new portfolio compananies?	major	25%	**2.65**	1.31	20	major	31%	**3.00**	1.15	13	*0.438*
	some	60%				some	54%				
	none	15%				none	15%				
On the 'strategic' level of corporate management?	major	57%	3.52	1.29	21	major	54%	3.46	1.45	13	*0.897*
	some	38%	*(rank 1)*			some	31%	*(rank 1)*			
	none	5%				none	15%				
On the 'institutional' level of corporate management?	major	44%	3.22	1.40	18	major	17%	2.42	1.16	12	*0.110*
	some	39%	*(rank 2)*			some	50%	*(rank 4)*			
	none	17%				none	33%				
On the 'business level of corporate management?	major	38%	3.14	1.01	21	major	23%	2.62	0.96	13	*0.143*
	some	62%	*(rank 3)*			some	69%	*(rank 3)*			
	none	0%				none	8%				
On the 'operative' level of corporate management?	major	25%	2.30	1.49	20	major	23%	2.77	1.42	13	*0.375*
	some	35%	*(rank 4)*			some	62%	*(rank 2)*			
	none	40%				none	15%				

p < 0.100, p** < 0.050, p*** < 0.010, p*** < 0.001*

TABLE G Influence of funders on venture capital company decision making (1992, 1997)

(Rated 1-5: 1 for no influence, 2-3 for some influence, 4-5 for major influence)

INFLUENCE OF FUNDERS ON DECISION MAKING REGARDING:		AMERICA 1992 Entrepreneurial Influence (rank)	AMERICA 1992 Corporate Influence (rank)	FINLAND 1992 Corporate Influence (rank)	FINLAND 1992 Governmental Influence (rank)	FINLAND 1997 Corporate Influence (rank)	FINLAND 1997 Governmental. Influence (rank)
Mission (Mission + strategy in 1997)	major	43% (1)	**50%** (1)	**77%**(1)	**80%** (2)	**57%** (1)	**82%** (1)
	some	37%	25%	23%	20%	43%	18%
	none	20%	25%	0%	0%	0%	0%
Strategy (Fund-raising in 1997)	major	37%(2)	25% (2)	**77%**(1)	**80%** (1)	43%(3)	**55%** (2)
	some	46%	50%	23%	20%	0%	0%
	none	17%	25%	0%	0%	**57%**	45%
Exiting decisions	major	26%(2)	0% (5)	38% (3)	10% (5)	14% (5)	0% (6)
	some	60%	63%	54%	80%	43%	27%
	none	14%	38%	8%	10%	43%	**73%**
Value adding decisions	major	26% (4)	0% (4)	8% (5)	10% (6)	0% (6)	9% (5)
	some	46%	63%	69%	70%	29%	36%
	none	29%	38%	23%	20%	**71%**	**55%**
Investment criteria	major	23% (5)	13% (3)	14%(5)	30% (4)	29%(3)	27% (3)
	some	54%	50%	79%	70%	43%	64%
	none	23%	38%	7%	0%	29%	9%
Entering decisions	major	20% (6)	13%(5)	36% (4)	67% (3)	57% (2)	18% (4)
	some	40%	25%	57%	11%	43%	73%
	none	40%	**63%**	7%	22%	0%	9%

TABLE H Descriptive statistics on who makes the venture capital investment decision (1989, 1992)

(Rated 1-5: 1-2 for none, 3-4 for some, 5 for great influence on decision making)

WHO MAKES THE VENTURE CAPITAL INVESTMENT DECISION	FINLAND 1989 Corporate Power	n	Governmental Power	n	AMERICA 1992 Entrepreneurial Power	n	Corporate Power	n	FINLAND 1992 Corporate Power	n	Governmental Power	n
Funders (Owners in 1989)	great 7% some 40% none 53%	15	great 13% some 13% none 75%	8	great 7% some 13% none 80%	30	great 0% some 0% none 100%	6	great 0% some 57% none 43%	7	great 0% some 14% none 86%	7
Board of directors	great **62%** some 38% none 0%	21	great **58%** some 42% none 0%	12	great 0% some 20% none 80%	25	great 14% some 14% none 71%	7	great **79%** some 21% none 0%	14	great **63%** some 25% none 13%	8
Senior management	great 39% some 50% none 11%	18	great 25% some 63% none 13%	8	great **86%** some 9% none 6%	35	great **75%** some 25% none 0%	8	great **50%** some 50% none 0%	12	great 14% some 43% none 43%	7
Junior management	n.a.		n.a.		great 4% some 36% none 61%	28	great 33% some 50% none 17%	6	great 0% some 67% none 33%	6	great 13% some 13% none 75%	8
President	great **53%** some 37% none 11%	19	great 45% some 45% none 9%	11	great **58%** some 8% none 35%	26	great **60%** some 20% none 20%	5	great 46% some 54% none 0%	13	great 38% some 25% none 38%	8
Other one manager	great 8% some 31% none 62%	13	great **67%** some 33% none 0%	**3**	great 0% some 4% none 96%	23	great 25% some 0% none 75%	4	great 33% some 0% none 67%	3	great 0% some 33% none 67%	6

TABLE I The board of directors decision making principle (1992)

HOW DOES THE BOARD MAKE DECISIONS?	AMERICA Entrepreneurial		Corporate		FINLAND Corporate		1992 Governmental	
According to:	*n*		*n*		*n*		*n*	
A simple majority	6	19%	4	44%	2	13%	3	30%
A consensus principle	16	50%	4	44%	4	27%	7	70%
A unanimous vote	10	31%	1	11%	9	60%	0	0%
Total:	*32*	*100%*	*9*	*100%*	*15*	*100%*	*10*	*100%*
Based on:	*n*		*n*		*n*		*n*	
One vote per person	25	83%	8	89%	13	100%	9	100%
Shares held in VC firm	3	10%	1	11%	0	0%	0	0%
Money invested in funds	2	7%	0	0%	0	0%	0	0%
Total:	*30*	*100%*	*9*	*100%*	*13*	*100%*	*9*	*100%*

TABLE J Venture capital company's investment criteria (1989, 1992)

VENTURE CAPITAL COMPANY'S INVESTMENT CRITERIA	*(Rated 1-5: from least to most important)*							*(Rated 0-100: from least to most important)*												
	FINLAND 1989							AMERICA 1992						FINLAND 1992						
	Corporate			Governmental			*ANOVA*	Entrepreneurial			Corporate			Corporate			Governmental			*ANOVA*
	Mean	n	SD	Mean	n	SD	*P-value*	Mean	n	SD	Mean	n	SD	Mean	n	SD	Mean	n	SD	*P-value*
Industry	**4.48**	21	0.75	**3.36**	11	1.29	*0.004****	**64.7**	34	26.9	**60.0**	7	23.8	**75.5**	11	24.2	**61.3**	8	15.5	*0.508*
Expected final ROI	**4.43**	21	0.68	**3.73**	11	1.49	*0.075**	**87.8**	34	15.0	**82.1**	7	15.2	**85.5**	11	18.1	**70.0**	8	25.6	*0.082**
Market	**4.29**	21	0.96	**4.27**	11	0.90	*0.971*	**81.2**	34	19.4	**77.9**	7	10.8	**79.1**	11	7.0	**87.5**	8	10.4	*0.630*
Product	**4.29**	21	0.78	**3.82**	11	1.17	*0.187*	**67.1**	34	26.0	**67.1**	7	30.4	**80.9**	11	18.1	**70.0**	8	23.9	*0.455*
General ability of mgmt	**4.19**	21	0.81	**4.55**	11	1.04	*0.294*	**89.3**	34	12.1	**94.7**	7	4.7	**89.6**	11	12.3	**96.3**	8	7.4	*0.320*
Size of ownership stake	**3.81**	21	0.93	**2.82**	11	1.33	*0.019***	**58.7**	34	25.9	**53.6**	7	32.0	**71.8**	11	18.9	**57.5**	8	26.6	*0.410*
Control over management	**3.24**	21	1.26	**3.18**	11	0.75	*0.893*	**47.2**	34	29.1	**47.1**	7	18.0	**61.8**	11	16.6	**71.9**	8	14.6	*0.049***
Debt-to-equity ratio	**3.10**	21	1.09	**3.55**	11	1.13	*0.282*	**51.9**	34	26.5	**57.9**	7	14.7	**71.8**	11	10.8	**71.3**	8	16.4	*0.030***
Business risk	**3.10**	21	1.14	**3.00**	11	1.18	*0.826*	**40.0**	34	25.4	**32.9**	7	28.1	**62.7**	11	11.9	**50.6**	8	20.1	*0.023***
Marketing skills	**3.10**	21	1.14	**3.00**	11	1.10	*0.821*	**78.1**	34	17.8	**70.7**	7	19.7	**71.8**	11	19.4	**74.4**	8	22.3	*0.678*
Entrepreneurial culture	**2.81**	21	0.98	**2.18**	11	1.25	*0.128*	**69.3**	34	23.1	**54.3**	7	19.9	**63.6**	11	22.5	**70.6**	8	25.7	*0.526*
Geographical location	**2.14**	21	1.20	**3.36**	11	1.96	*0.036***	**66.2**	34	29.9	**45.0**	7	31.5	**59.1**	11	31.8	**58.1**	8	32.7	*0.406*
Financial skills	**2.10**	21	1.14	**1.91**	11	0.83	*0.635*	**60.0**	34	24.6	**64.3**	7	14.0	**48.2**	11	24.8	**55.0**	8	23.3	*0.434*
Other participants of deal	**2.00**	21	0.89	**2.09**	11	1.22	*0.811*	**55.8**	34	27.3	**62.9**	7	22.2	**52.7**	11	32.6	**71.3**	8	15.5	*0.418*
Fiscal aspects	**1.71**	21	0.78	**1.00**	11	0.00	*0.005****	**13.3**	34	16.9	**15.7**	7	19.0	**39.6**	11	27.4	**22.5**	8	21.2	*0.004****

p < 0.100, p** < 0.050, p*** < 0.010, p*** < 0.001*

TABLE K Historical deal flow closing rate (1989, 1992)

HISTORICAL DEAL FLOW CLOSING RATE (PERCENTAGE)	*(accumulated total number of deals closed per accumulated total deal flow)* FINLAND 1989 Corporate Mean SD n	Governmental Mean SD n	*ANOVA* P value	AMERICA 1992 Entrepreneurial Mean SD n	Corporate Mean SD n	FINLAND 1992 Corporate Mean SD n	Governmental. Mean SD n	*ANOVA* *P value*
Deal flow closing %	**10.1** 8.13 17	**12.4** 14.8 11	*0.595*	**1.6** 1.73 27	**2.9** 2.63 8	**9.8** 12.7 13	**23.0** 30.0 7	*0.001****
Ranging between:	below 1 6%	below 1 9%		below 1 **52%**	below 1 25%	below 1 0%	below 1 0%	
	1-1.99 6%	1-1.99 9%		1-1.99 22%	1-1.99 **38%**	1-1.99 31%	1-1.99 0%	
	2-9.99 35%	2-9.99 36%		2-9.99 26%	2-9.99 **38%**	2-9.99 **46%**	2-9.99 **71%**	
	10 plus **53%**	10 plus **45%**		10 plus 0%	10 plus 0%	10 plus 23%	10 plus 29%	

p < 0.100, p** < 0.050, p*** < 0.010, p*** < 0.001*

TABLE L Origin of leads for closed deals (1992)

ORIGIN OF CLOSED DEALS: WHERE DO THE LEADS COME FROM?	*(Rated 1-5: 1-2 for none, 3-4 for some, and 5 for great)* Entrepreneurial AMERICA Importance	Mean *(rank)*	SD	n	Corporate AMERICA Importance	Mean *(rank)*	SD	n	Corporate FINLAND Importance	Mean *(rank)*	SD	n	SURVEY 1992 Governmental FINLAND Importance	Mean *(rank)*	SD	n	*ANOVA P value*
Your own active search	great 40%	**4.11**	0.99	35	great 22%	3.67	0.87	9	great 29%	4.00	0.88	14	great 25%	3.63	1.06	8	*0.443*
for promising	some 51%	*(rank 1)*			some 78%	*(rank 1)*			some 64%	***(rank 3)***			some 63%	***(rank 3)***			
targets	none 9%				none 0%				none 7%				none 13%				
Approach by entrepreneur	great 23%	3.83	0.82	35	great 11%	3.33	1.22	9	great 36%	4.29	0.61	14	great 75%	**4.75**	0.46	8	*0.003****
or other owners of	some 74%	*(rank 2)*			some 67%	*(rank 3)*			some 64%	*(rank 1)*			some 25%	*(rank 1)*			
the target company	none 3%				none 22%				none 0%				none 0%				
Recommendations from	great 6%	**3.49**	0.82	35	great 11%	3.11	1.17	9	great 8%	3.08	0.95	13	great 13%	3.35	1.07	8	*0.450*
outside the venture	some 80%	*(rank 3)*			some 67%	***(rank 5)***			some 62%	*(rank 4)*			some 63%	*(rank 4)*			
capital community	none 14%				none 22%				none 31%				none 25%				
Approach by the target	great 21%	3.48	1.09	33	great 11%	3.33	1.22	9	great 29%	4.07	0.73	14	great 63%	**4.63**	0.52	8	*0.013***
company	some 61%	*(rank 4)*			some 67%	*(rank 3)*			some 71%	***(rank 2)***			some 38%	***(rank 2)***			
management	none 18%				none 22%				none 0%				none 0%				
Recommendations from	great 11%	3.17	1.25	35	great 22%	**3.67**	1.12	9	great 0%	2.33	0.98	12	great 0%	3.02	1.19	8	*0.051**
other venture capital	some 60%	*(rank 5)*			some 56%	***(rank 1)***			some 50%	*(rank 5)*			some 63%	*(rank 5)*			
companies	none 29%				none 22%				none 50%				none 38%				
Participation to a syndicated	great 0%	1.47	0.61	34	great 0%	**2.11**	1.27	9	great 0%	1.91	0.70	11	great 0%	1.69	0.83	8	*0.096**
deal as a passive	some 6%	*(rank 6)*			some 33%	*(rank 6)*			some 18%	*(rank 6)*			some 25%	*(rank 6)*			
investor	none 94%				none 67%				none 82%				none 75%				

p < 0.100, p** < 0.050, p*** < 0.010, p*** < 0.001*

TABLE M Relative importance of stakeholder groups when buying portfolio interests (1992)

(Rated 1-5: 1 for none, 2-3 for some, and 4-5 for major) SURVEY 1992

IMPORTANCE OF STAKEHOLDER GROUPS WHEN *ENTERING*	Entrepreneurial AMERICA Importance		Mean	SD	n	Corporate AMERICA Importance		Mean	SD	n	Corporate FINLAND Importance		Mean	SD	n	Governmental FINLAND Importance		Mean	SD	n	*ANOVA P value*
Commercial banks	major	0%	1.30	0.59	33	major	0%	1.00	0.00	6	major	40%	3.00	1.25	10	major	25%	2.75	0.96	4	*0.000****
	some	24%				some	0%				some	50%				some	75%				
	none	76%				none	100%				none	10%				none	0%				
M&A brokers	major	6%	1.73	1.04	33	major	0%	1.17	0.41	6	major	0%	1.75	0.71	8	major	0%	1.75	0.50	4	*0.572*
	some	36%				some	17%				some	62%				some	75%				
	none	58%				none	83%				none	38%				none	25%				
Outside independent investment consultants	major	26%	2.54	1.38	35	major	14%	2.14	1.07	7	major	20%	2.60	0.97	10	major	0%	2.50	0.58	4	*0.878*
	some	43%				some	57%				some	70%				some	100%				
	none	31%				none	29%				none	10%				none	0%				
Other venture capital companies	major	49%	3.29	1.20	35	major	13%	2.75	1.16	8	major	17%	2.67	1.07	12	major	33%	2.67	1.53	3	*0.336*
	some	40%				some	75%				some	58%				some	33%				
	none	11%				none	13%				none	25%				none	33%				
Investment banks	major	9%	2.15	1.16	34	major	0%	1.40	0.55	5	major	25%	2.50	1.20	8	major	0%	1.67	0.58	3	*0.323*
	some	53%				some	40%				some	50%				some	67%				
	none	39%				none	60%				none	25%				none	33%				
Academicians	major	18%	2.15	1.33	33	major	40%	2.40	1.52	5	major	17%	1.83	1.33	6	major	0%	2.00	1.15	4	*0.908*
	some	39%				some	20%				some	17%				some	50%				
	none	42%				none	40%				none	67%				none	50%				

p < 0.100, p** < 0.050, p*** < 0.010, p*** < 0.001*

TABLE N Relative importance of stakeholder groups when selling portfolio interests (1992)

IMPORTANCE OF STAKEHOLDER GROUPS WHEN *EXITING*	*(Rated 1-5: 1 for none, 2-3 for some, and 4-5 for major)* Entrepreneurial AMERICA					Corporate AMERICA					Corporate FINLAND					Governmental FINLAND					SURVEY 1992 *ANOVA*
	Importance		Mean	SD	n	Importance		Mean	SD	n	Importance		Mean	SD	n	Importance		Mean	SD	n	*P value*
Commercial banks	major	7%	1.46	0.92	28	major	0%	1.00	0.00	6	major	25%	2.88	1.13	8	major	0%	2.60	0.55	5	*0.000****
	some	18%				some	0%				some	75%				some	100%				
	none	75%				none	100%				none	0%				none	0%				
M&A brokers	major	25%	2.56	1.32	32	major	14%	2.14	1.21	7	major	0%	2.29	0.76	7	major	20%	2.80	1.10	5	*0.758*
	some	47%				some	43%				some	100%				some	60%				
	none	28%				none	43%				none	14%				none	20%				
Outside independent investment consultants	major	23%	2.27	1.31	30	major	0%	1.80	0.84	5	major	22%	2.89	0.93	9	major	20%	2.60	0.89	5	*0.356*
	some	40%				some	60%				some	67%				some	80%				
	none	37%				none	40%				none	11%				none	0%				
Other venture capital companies	major	42%	2.88	1.32	33	major	0%	2.33	0.82	6	major	22%	2.78	1.09	9	major	60%	3.60	0.55	5	*0.379*
	some	33%				some	83%				some	56%				some	40%				
	none	24%				none	17%				none	22%				none	0%				
Investment banks	major	61%	3.55	1.28	33	major	57%	3.57	1.40	7	major	25%	2.50	1.20	8	major	40%	3.00	1.22	5	*0.194*
	some	27%				some	29%				some	50%				some	40%				
	none	12%				none	14%				none	25%				none	10%				
Academicians	major	4%	1.39	0.79	28	major	0%	1.00	0.00	5	major	17%	1.50	1.22	6	major	0%	1.40	0.55	5	*0.738*
	some	21%				some	0%				some	0%				some	40%				
	none	75%				none	100%				none	83%				none	60%				

p < 0.100, p** < 0.050, p*** < 0.010, p*** < 0.001*

TABLE O Relative importance of stakeholder groups when buying and selling portfolio interests (1997)

IMPORTANCE OF STAKEHOLDER GROUPS	=> WHEN *ENTERING (rated 1 for none, 2-3 some, 4-5 major):* Corporate Importance	Mean	SD	n	Governmental Importance	Mean	SD	n	*ANOVA P value*	=> WHEN *EXITING*: Corporate Importance	Mean	SD	n	Governmental Importance	Mean	SD	n	FINLAND 1997 *ANOVA P value*
Own funders	major 67%	**3.67**	1.03	6	major 40%	**2.80**	1.23	10	*0.171*	major 60%	**3.00**	1.41	5	major 38%	**2.75**	1.28	8	*0.748*
	some 33%				some 40%					some 20%				some 38%				
	none 0%				none 20%					none 20%				none 25%				
Lawyers and auditors	major 67%	**3.50**	0.84	6	major 10%	**1.90**	1.10	10	*0.009****	major 40%	**2.60**	1.34	5	major 25%	**2.25**	1.28	8	*0.647*
	some 33%				some 40%					some 40%				some 38%				
	none 0%				none 50%					none 10%				none 38%				
Other VC companies	major 40%	**2.80**	1.64	5	major 40%	**3.00**	1.33	10	*0.803*	major 75%	**4.50**	1.00	4	major 63%	**3.38**	1.60	8	*0.232*
	some 40%				some 40%					some 25%				some 12%				
	none 20%				none 20%					none 0%				none 25%				
Banks/insurance companies	major 67%	**3.67**	1.03	6	major 40%	**3.10**	1.20	10	*0.353*	major 40%	**3.00**	1.22	5	major 50%	**3.00**	1.51	8	*1.000*
	some 33%				some 50%					some 40%				some 25%				
	none 0%				none 10%					none 20%				none 25%				
Financial advisers	major 33%	**2.67**	1.03	6	major 45%	**3.00**	1.34	11	*0.606*	major 40%	**2.80**	1.30	5	major 38%	**2.88**	1.46	8	*0.927*
	some 67%				some 36%					some 40%				some 38%				
	none 0%				none 18%					none 20%				none 25%				
Dating services and data banks	major 17%	**2.00**	1.26	6	major 10%	**1.80**	1.14	10	*0.748*	major 20%	**2.20**	1.30	5	major 0%	**2.00**	0.93	8	*0.751*
	some 33%				some 30%					some 40%				some 63%				
	none 50%				none 60%					none 40%				none 37%				
Public sector entities	major 0%	**1.83**	0.98	6	major 36%	**2.91**	1.45	11	*0.126*	major 0%	**1.40**	0.55	5	major 38%	**2.00**	1.07	8	*0.274*
	some 50%				some 45%					some 40%				some 50%				
	none 50%				none 18%					none 60%				none 13%				

TABLE P Venture capital company's definition for value-adding (1992, 1997)

Alternative A: *"We want to add value to our holdings in our portfolio companies any way we can (we are in this to make money by buying and selling such interests). If the portfolio companies make a future out of our efforts, that is a positive side effect."*

Alternative B: *"We want to secure the future of our portfolio companies any way we can (we are in this to add to the well-being of our portfolio companies). If we make money on the side, that is a positive side effect."*

Alternative C: *"We want to pass idea and innovation to our funders any way we can (we are in this to serve the strategic interests of our funders). If the target firms make a future out of our efforts, and if we make some money, those are positive side effects."*

WHAT BEST DESCRIBES	AMERICA 1992				FINLAND 1992				FINLAND 1997			
YOUR VALUE-ADDING	Entrepreneurial		Corporate		Corporate		Governmental		Corporate		Governmental	
Alternative A	25	**71%**	**7**	**78%**	5	36%	1	11%	4	**50%**	3	27%
Alternative B	9	26%	2	22%	7	**50%**	8	**89%**	4	**50%**	**7**	**64%**
Alternative C	1	3%	0	0%	2	14%	0	0%	0	0%	1	9%
Total	35	100%	9	100%	11	100%	9	100%	8	100%	11	100%

TABLE Q Participation and influence of value-adding work on the investee-businesses detailed by function (1992)

(Rated 1-5: 1 for none, 2-3 for some, and 4-5 for major) SURVEY 1992

VALUE-ADDING INFLUENCE BY FUNCTION	Entrepreneurial AMERICA Influence	Mean *(rank)*	SD	n	Corporate AMERICA Influence	Mean *(rank)*	SD	n	Corporate FINLAND Influence	Mean *(rank)*	SD	n	Governmental FINLAND Influence	Mean *(rank)*	SD	n	*ANOVA P value*
Strategic planning	major 88%	**4.53**	0.71	34	major 86%	**4.14**	0.69	7	major 100%	**4.67**	0.49	15	major 100%	**4.89**	0.33	9	*0.115*
	some 12%	*(rank 1)*			some 14%	*(rank 2)*			some 0%	*(rank 1)*			some 0%	*(rank 1)*			
	none 0%				none 0%				none 0%				none 0%				
Corporate governance	major 82%	**4.29**	0.91	34	major 86%	**4.43**	0.79	7	major 67%	**4.07**	0.88	15	major 67%	**3.78**	1.20	9	*0.416*
	some 18%	*(rank 2)*			some 14%	*(rank 1)*			some 33%	*(rank 2)*			some 33%	*(rank 2)*			
	none 0%				none 0%				none 0%				none 0%				
Accounting and finance	major 82%	**3.91**	0.71	34	major 44%	**3.44**	0.88	9	major 80%	**3.87**	0.52	15	major 67%	**3.78**	1.20	9	*0.456*
	some 18%	*(rank 3)*			some 56%	*(rank 4)*			some 20%	*(rank 3)*			some 33%	*(rank 2)*			
	none 0%				none 0%				none 0%				none 0%				
Sales and marketing	major 44%	**3.32**	0.94	34	major 44%	**3.56**	1.01	9	major 13%	**2.80**	1.01	15	major 56%	**3.22**	0.97	9	*0.246*
	some 53%	*(rank 4)*			some 56%	*(rank 3)*			some 73%	*(rank 4)*			some 44%	*(rank 4)*			
	none 3%				none 0%				none 13%				none 0%				
General management	major 26%	**2.69**	1.23	35	major 0%	**1.71**	0.76	7	major 0%	**1.87**	0.83	15	major 11%	**2.44**	1.01	9	*0.040***
	some 54%	*(rank 5)*			some 57%	***(rank 7)***			some 60%	***(rank 7)***			some 67%	*(rank 6)*			
	none 20%				none 43%				none 40%				none 22%				
Research and development	major 32%	**2.32**	1.15	34	major 50%	**2.75**	1.67	8	major 27%	**2.60**	1.18	15	major 22%	**2.67**	1.00	9	*0.723*
	some 53%	*(rank 6)*			some 13%	*(rank 5)*			some 47%	*(rank 5)*			some 67%	*(rank 5)*			
	none 31%				none 38%				none 27%				none 11%				
Production	major 9%	**2.12**	0.95	34	major 13%	**2.25**	1.28	8	major 7%	**1.93**	0.80	15	major 11%	**1.89**	1.05	9	*0.812*
	some 62%	*(rank 7)*			some 63%	*(rank 6)*			some 67%	*(rank 6)*			some 44%	*(rank 7)*			
	none 29%				none 25%				none 27%				none 44%				

p < 0.100, p** < 0.050, p*** < 0.010, p*** < 0.001*

TABLE R Participation and influence of value-adding work on the investee-businesses detailed by function (1997)

VALUE-ADDING INFLUENCE BY FUNCTION	*(rated 0-5: 0-1 none, 2-3 some, 4-5 major)* Corporate Influence		Mean *(rank)*	SD	n	Governmental Influence		Mean *(rank)*	SD	n	FINLAND 1997 *ANOVA P value*
Strategic planning	major	100%	**4.63**	0.52	8	major	90%	**4.30**	0.67	10	*0.279*
	some	0%	*(rank 1)*			some	10%	*(rank 1)*			
	none	0%				none	0%				
Corporate governance	major	75%	**4.38**	0.92	8	major	36%	**3.64**	0.92	11	*0.102*
	some	25%	*(rank 2)*			some	64%	***(rank 5)***			
	none	0%				none	0%				
Accounting and finance	major	75%	**4.25**	1.17	8	major	40%	**4.10**	0.74	10	*0.743*
	some	25%	*(rank 3)*			some	60%	*(rank 2)*			
	none	0%				none	0%				
Internationalisation	major	75%	**3.88**	0.64	8	major	70%	**3.90**	0.74	10	*0.941*
	some	25%	*(rank 4)*			some	30%	*(rank 3)*			
	none	0%				none	0%				
Sales and marketing	major	50%	**3.50**	0.53	8	major	70%	**3.90**	0.99	10	*0.322*
	some	50%	*(rank 5)*			some	30%	***(rank 3)***			
	none	0%				none	0%				
Research and development	major	25%	**2.25**	1.39	8	major	40%	**3.30**	0.95	10	*0.075**
	some	50%	*(rank 6)*			some	60%	*(rank 6)*			
	none	25%				none	0%				
Production	major	13%	**2.25**	1.17	8	major	10%	**2.20**	1.23	10	*0.931*
	some	50%	*(rank 7)*			some	60%	*(rank 7)*			
	none	38%				nonc	30%				

$p^{*} < 0.100$, $p^{**} < 0.050$, $p^{***} < 0.010$, $p^{***} < 0.001$

TABLE 5 Relative importance of value adding related roles (1992)

IMPORTANCE OF VALUE-ADDING RELATED ROLES	*(Rated 1-5: 1-2 for none, 3-4 for some, and 5 for great)* Entrepreneurial AMERICA Importance	Mean *(rank*	SD	n	Corporate AMERICA Importance	Mean *(rank*	SD	n	Corporate FINLAND Importance	Mean *(rank*	SD	n	SURVEY 1992 Governmental FINLAND Importance	Mean *(rank)*	SD	n	*ANOVA P value*
Sounding board (you listen	great 65%	4.56	0.66	34	great 56%	4.33	0.87	9	great 13%	3.80	0.68	15	great 38%	4.32	0.75	8	*0.010***
to problems, respond	some 35%	*(rank 1)*			some 44%	*(rank 1)*			some 87%	***(rank 5)***			some 63%	*(rank 2)*			
frankly, truthfully)	none 0%				none 0%				none 0%				none 0%				
Financier (you provide	great 53%	4.47	0.61	34	great 33%	3.67	1.41	9	great 33%	3.93	1.03	15	great 44%	4.00	1.32	9	*0.080**
or arrange timely	some 47%	*(rank 2)*			some 44%	***(rank 4)***			some 53%	*(rank 3)*			some 44%	*(rank 4)*			
funding)	none 0%				none 22%				none 13%				none 11%				
Business consultant (you	great 53%	4.44	0.70	34	great 33%	4.22	0.67	9	great 40%	4.20	0.77	15	great 63%	4.50	0.76	8	*0.619*
discuss plans, provide	some 44%	*(rank 3)*			some 67%	*(rank 2)*			some 60%	***(rank 1)***			some 38%	***(rank 1)***			
mgmt assistance, etc.)	none 3%				none 0%				none 0%				none 0%				
Coach/mentor (you provide	great 44%	4.14	0.89	34	great 33%	4.11	0.78	9	great 20%	3.93	0.80	15	great 38%	4.08	0.86	8	*0.875*
encouragement, support,	some 53%	*(rank 4)*			some 67%	*(rank 3)*			some 73%	*(rank 3)*			some 50%	*(rank 3)*			
and motivation)	none 3%				none 0%				none 7%				none 13%				
Source of professional	great 29%	4.00	0.78	34	great 11%	3.67	1.12	9	great 20%	4.00	0.76	15	great 0%	3.50	0.76	8	*0.352*
contacts (for lawyers,	some 71%	*(rank 5)*			some 78%	*(rank 4)*			some 73%	***(rank 2)***			some 88%	*(rank 6)*			
consultants, etc.)	none 0%				none 11%				none 7%				none 13%				
Management recruiter	great 32%	3.94	0.92	34	great 22%	3.44	1.01	9	great 20%	3.47	1.13	15	great 13%	3.67	1.04	8	*0.139*
(you help locate key	some 62%	*(rank 6)*			some 67%	*(rank 6)*			some 53%	*(rank 6)*			some 63%	*(rank 5)*			
members of mgmt team)	none 6%				none 11%				none 27%				none 25%				
Friend/confidant (you are	great 24%	3.56	1.11	34	great 0%	3.00	0.76	8	great 0%	3.00	0.85	15	great 0%	3.34	1.02	8	*0.250*
concerned for the CEOs	some 59%	*(rank 7)*			some 75%	*(rank 7)*			some 80%	*(rank 7)*			some 88%	*(rank 7)*			
as individuals)	none 18%				none 25%				none 20%				none 13%				
Source of industry contacts	great 18%	3.56	1.05	34	great 11%	2.89	1.27	9	great 0%	2.87	0.83	15	great 0%	2.75	0.71	8	*0.046***
(that help generate	some 65%	*(rank 7)*			some 44%	*(rank 8)*			some 73%	*(rank 8)*			some 63%	*(rank 8)*			
orders, etc.)	none 18%				none 44%				none 27%				none 38%				

$p^{*} < 0.100$, $p^{**} < 0.050$, $p^{***} < 0.010$, $p^{***} < 0.001$

TABLE T Absolute importance of value-adding roles (1992)

ABSOLUTE IMPORTANCE OF VALUE-ADDING RELATED ROLES				SURVEY 1992
1.	Sounding board	Entrepreneurial		('rank total' 90)
2.	Business consultant		Governmental	('rank total' 134)
3.	Financier	Entrepreneurial		
4.	Business consultant	Entrepreneurial		
5.	Sounding board	Corporate American		('rank total' 147)
6.	Sounding board		Governmental	
7.	Business consultant	Corporate American		
8.	Business consultant		Corporate Finnish	('rank total' 157)
9.	Coach/mentor	Entrepreneurial		
10.	Coach/mentor	Corporate American		
11.	Coach/mentor		Governmental	
12.	Financier		Governmental	
13.	Source/prof. contacts	Entrepreneurial		
14.	Source/prof. contacts		Corporate Finnish	
15.	Mgmt recruiter	Entrepreneurial		
16.	Financier		Corporate Finnish	
17.	Coach/mentor		Corporate Finnish	
18.	Sounding board		Corporate Finnish	
19.	Financier	Corporate American		
20.	Mgmt recruiter		Governmental	
21.	Source/prof. contacts	Corporate American		
22.	Friend, confidant	Entrepreneurial		
23.	Source/ind. contacts	Entrepreneurial		
24.	Source/prof. contacts		Governmental	
25.	Mgmt recruiter		Corporate Finnish	
26.	Mgmt recruiter	Corporate American		
27.	Friend, confidant		Governmental	
28.	Friend, confidant		Corporate Finnish	
29.	Friend, confidant	Corporate American		
30.	Source/ind. contacts	Corporate American		
31.	Source/ind. contacts		Corporate Finnish	
32.	Source/ind. contacts		Governmental	

TABLE U Absolute importance of the three marketing tasks (1992)

ABSOLUTE IMPORTANCE OF THE THREE MARKETING TASKS				SURVEY 1992
1.	Entering		Governmental	('rank total' 20)
2.	Fund-raising	Entrepreneurial		('rank total' 10)
3.	Exiting	Entrepreneurial		
4.	Entering	Corporate American		('rank total' 27)
5.	Entering	Entrepreneurial		
6.	Exiting		Corporate Finnish	('rank total' 21)
7.	Entering		Corporate Finnish	
8.	Fund-raising		Corporate Finnish	
9.	Exiting		Governmental	
10.	Fund-raising		Governmental	
11.	Fund-raising	Corporate American		
12.	Exiting	Corporate American		

TABLE V A quest for other marketing tasks(1992)

OTHER IMPORTANT MARKETING TASKS?	AMERICA Entrepreneurial			Corporate			FINLAND Corporate			1992 Governmental		
Can you think of other marketing tasks?	**yes**	**11**	**33%**	**yes**	**2**	**22%**	**yes**	**4**	**31%**	**yes**	**6**	**67%**
	no	13	39%	no	5	56%	no	7	54%	no	3	33&
	n.a.	9	27%	n.a.	2	22%	n.a.	2	15%	n.a.	0	0%
	total	33	100%	total	9	100%	total	13	100%	total	9	100%
If yes, are these more important than the given three?	**yes**	**4**	**12%**	**yes**	**0**	**0%**	**yes**	**0**	**0%**	**yes**	**1**	**11%**
	no	20	61%	no	7	78%	no	11	85%	no	8	89&
	n.a.	9	27%	n.a.	2	22%	n.a.	2	15%	n.a.	0	0%
	total	33	100%	total	9	100%	total	13	100%	total	9	100%

Respondents were asked to define the other marketing tasks that they could think of (those that were rated more important than the three marketing tasks appear in ***bold italics*** on top of each list):

Entrepreneurial: (America)

1. ***Among peers and trade allies regarding referrals***
2. ***Direct mail solicitation to brokers, M&A specialists; protect their fees***
3. ***To referral sources***
4. ***Marketing ideas/strategy to investee management during value adding***
5. Multinational working partnerships bw portfolio firms and investor-partners
6. To employees
7. Sell capabilities to the infrastructure – lawyers, auditors, banks, universities
8. To other VC firms so that partners' oral syndications include our firm
9. We want to be well known and highly regarded by other VC companies
10. To banking sources
11. Awareness in the business community of the strengths and interest

Corporate: (America)

1. Potential employees, investment banks, consultants, etc.
2. Marketing the venture capital company to (i) venture capital community, (ii) investment community, (iii) political community

Corporate: (Finland)

1. Venture capital is only one of our financing activities
2. Marketing the products of portfolio companies and the entire VC industry
3. Marketing corporate finance services
4. Advisory services, contact network

Governmental: (Finland)

1. ***Advisory services to also other (than portfolio) companies***
2. Leasing activity; leasing office and production facilities and land
3. Increasing awareness of the importance of VC and high tech enterprising
4. Other than parties listed (in the three); banks, municipalities, government
5. Marketing the entire venture capital industry
6. Selling consulting services

TABLE W A quest for other marketing tasks (1997)

MORE IMPORTANT MARKETING TASKS?	Corporate sample	n	%	Governmental	n	%
						FINLAND 1997
Are there more important marketing tasks?	yes	2	25%	yes	4	36%
	no	3	38%	no	6	55%
	n.a.	3	38%	n.a.	1	9%
	total	8	100%	total	11	100%

Respondents were asked to define the marketing task(s) that they found more important:

More important marketing tasks (Corporate):
1. Networking within the parent's group organisation.
2. Marketing tasks related to re-leasing activity.

More important marketing tasks (Governmental):
1. Seeking public listing for the company's own shares.
2. Explaining to the public what venture capital is.
3. Enhancing stable growth and development of the Finnish economy.
4. Developing also the other (than portfolio) businesses of the region.

TABLE X Discovering the product of the venture capital company(1992)

EVALUATING THE *"PRODUCTS"* OF THE VC COMPANY	*(Rated 1-5: from least to most important product, 5=top rate)* Entrepreneurial AMERICA					Corporate AMERICA					Corporate FINLAND					Governmental FINLAND					SURVEY 1992 *ANOVA*
	Top rate	Mean	SD	n	rank	Top rate	Mean	SD	n	rank	Top rate	Mean	SD	n	rank	Top rate	Mean	SD	n	rank	*P value*
at time of foundation																					
Value-adding	by 50%	**4.34**	0.75	32	*1*	by 43%	**4.00**	1.15	7	*2*	by 15%	**3.85**	0.69	13	*2*	by 0%	**2.40**	1.14	5	***4***	*0.548*
Capital	by 33%	**3.80**	1.16	30	*2*	by 33%	**4.11**	0.93	9	*1*	by 58%	**4.25**	1.06	12	*1*	by 0%	**3.71**	0.49	7	*2*	*0.000****
VC firm management	by 24%	**3.72**	0.96	29	*3*	by 25%	**4.00**	0.82	4	*2*	by 10%	**3.60**	0.70	10	*4*	by 43%	**3.86**	1.46	7	***1***	*0.900*
Portfolio firms	by 18%	**3.39**	1.13	28	*4*	by 13%	**3.75**	0.71	8	*4*	by 11%	**3.78**	0.83	9	*3*	by 33%	**3.50**	1.52	6	*3*	*0.741*
Other	by 13%	**3.00**	1.51	8	-	by 0%	**4.00**	n.a.	1	-	by100%	**5.00**	n.a.	1	-	by100%	**5.00**	0.00	2	-	*0.290*
at time of survey																					
Value-adding	by 63%	**4.50**	0.72	32	*1*	by 38%	**4.25**	0.71	8	*1*	by 38%	**4.23**	0.73	13	*1*	by 29%	**3.57**	1.13	7	***4***	*0.944*
Capital	by 21%	**3.48**	1.24	29	*4*	by 0%	**3.43**	0.79	7	*3*	by 10%	**3.50**	0.97	10	*3*	by 38%	**3.75**	1.39	8	*2*	*0.047***
VC firm management	by 15%	**3.56**	0.80	27	*2*	by 20%	**4.20**	0.45	5	*2*	by 45%	**4.09**	0.94	11	*2*	by 56%	**4.44**	0.73	9	*1*	*0.022***
Portfolio firms	by 25%	**3.54**	1.29	28	*3*	by 0%	**3.33**	0.82	6	*4*	by 0%	**3.30**	0.82	10	*4*	by 38%	**3.63**	1.51	8	*3*	*0.922*
Other	by 43%	**3.57**	1.81	7	-	by 0%	**3.00**	n.a.	1	-	by100%	**5.00**	n.a.	1	-	by 33%	**4.00**	1.00	3	-	*0.817*

p < 0.100, p** < 0.050, p*** < 0.010, p*** < 0.001*

TABLE Y Discovering the market of the venture capital company(1992)

EVALUATING THE "*MARKETS*" OF THE VC COMPANY	*(Rated 1-5: from least to most important market, 5=top rate)* Entrepreneurial AMERICA					Corporate AMERICA					Corporate FINLAND					Governmental FINLAND					SURVEY 1992 *ANOVA*
	Top rate	Mean	SD	n	rank	Top rate	Mean	SD	n	rank	Top rate	Mean	SD	n	rank	Top rate	Mean	SD	n	rank	*P value*
at time of foundation																					
Funders	by 45%	**4.17**	0.97	29	*1*	by 67%	**3.83**	1.83	6	*1*	by 18%	**3.64**	1.12	11	*2*	by 0%	**2.29**	1.25	7	***4***	*0.004****
Suppliers	by 39%	**4.00**	1.10	31	*2*	by 40%	**3.80**	1.64	5	*2*	by 75%	**4.67**	0.65	12	*1*	by 63%	**4.25**	1.16	8	*1*	*0.283*
Consumers	by 26%	**3.74**	1.18	23	*3*	by 0%	**3.00**	1.73	3	*3*	by 20%	**3.60**	0.97	10	*3*	by 0%	**3.00**	1.00	5	*2*	*0.489*
Government	by 0%	**1.50**	0.94	14	*4*	by 0%	**1.00**	n.a.	1	*4*	by 0%	**1.50**	0.71	2	*4*	by 17%	**3.00**	1.41	6	***2***	*0.054**
Other	by 57%	**4.00**	1.41	7	-	by 67%	**4.33**	1.15	3	-		**n.a.**		0		by100%	**5.00**	n.a.	1	-	*0.924*
at time of survey																					
Funders	by 46%	**4.04**	1.14	28	*2*	by 57%	**4.14**	1.46	7	*1*	by 18%	**3.64**	1.12	11	*2*	by 13%	**3.50**	1.20	8	***2***	*0.555*
Suppliers	by 43%	**4.20**	0.92	30	*1*	by 40%	**3.80**	1.64	5	*2*	by 50%	**4.33**	0.78	12	*1*	by 70%	**4.50**	0.85	10	*1*	*0.586*
Consumers	by 35%	**3.88**	1.15	24	*3*	by 0%	**2.50**	2.12	2	*3*	by 20%	**3.80**	0.92	10	*3*	by 0%	**3.17**	0.98	6	*3*	*0.245*
Government	by 0%	**1.64**	1.01	14	*4*	by 0%	**2.00**	1.41	2	*4*	by 0%	**1.67**	0.58	3	*4*	by 0%	**2.17**	0.75	6	*4*	*0.699*
Other	by 33%	**3.83**	1.17	6	-	by100%	**5.00**	0.00	2	-	by100%	**5.00**	n.a.	1	-	by 0%	**4.00**	0.00	2	-	*0.464*

p < 0.100, p** < 0.050, p*** < 0.010, p*** < 0.001*

TABLE Z Attempted innovation relative to industry practices during the various phases of the venture capital process (1992)

ATTEMPTED *INNOVATION* RELATIVE TO INDUSTRY PRACTICES CONCERNING:	*(Level of attempt rated 1-5: 1-2 for none, 3-4 for some, and 5 for great)* Entrepreneurial AMERICA Attempt	Mean *(rank)*	SD	n	Corporate AMERICA Attempt	Mean *(rank)*	SD	n	Corporate FINLAND Attempt	Mean *(rank)*	SD	n	Governmental Attempt	Mean *(rank)*	SD	n	SURVEY 1992 *ANOVA P value*
Value-adding strategies	great 41%	**4.0**	1.13	34	great 11%	**3.3**	1.00	9	great 15%	**3.9**	0.77	14	great 10%	**3.3**	0.82	10	*0.136*
	some 50%	*(rank 1)*			some 67%	*(rank 2)*			some 77%	*(rank 1)*			some 80%	*(rank 2)*			
	none 9%				none 22%				none 8%				none 10%				
Deal search strategies	great 21%	**3.6**	1.02	34	great 11%	**2.9**	1.05	9	great 23%	**3.9**	0.76	13	great 0%	**3.4**	0.70	10	*0.089**
	some 62%	*(rank 2)*			some 44%	*(rank 4)*			some 77%	*(rank 1)*			some 90%	*(rank 1)*			
	none 18%				none 44%				none 0%				none 10%				
Deal negotiation strategies	great 9%	**3.4**	1.04	34	great 11%	**3.6**	0.88	9	great 15%	**3.7**	0.75	13	great 10%	**2.9**	1.10	10	*0.269*
	some 71%	*(rank 3)*			some 78%	*(rank 1)*			some 85%	*(rank 3)*			some 60%	*(rank 3)*			
	none 20%				none 11%				none 0%				none 30%				
Fund-raising strategies	great 24%	**3.2**	1.38	34	great 22%	**2.9**	1.69	9	great 15%	**3.0**	1.08	13	great 0%	**2.7**	1.12	9	*0.760*
	some 44%	*(rank 4)*			some 33%	*(rank 4)*			some 62%	*(rank 5)*			some 44%	*(rank 4)*			
	none 32%				none 44%				none 23%				none 56%				
Exiting strategies	great 9%	**3.0**	1.03	34	great 11%	**3.0**	1.22	9	great 7%	**3.3**	0.99	14	great 0%	**2.2**	0.83	9	*0.113*
	some 62%	*(rank 5)*			some 56%	*(rank 3)*			some 64%	*(rank 4)*			some 44%	*(rank 5)*			
	none 29%				none 33%				none 29%				none 56%				

p < 0.100, p** < 0.050, p*** < 0.010, p*** < 0.001*

APPENDIX 7

OUTLINE OF THE CASE INTERVIEWS

(Translation from Finnish into English)

The mission of the interview is to trace, in-depth, for (i) the strategies of different owner-types (government, corporation, entrepreneur) and (ii) the effects of change of owner-type (from governmental to corporate, from corporate to entrepreneurial) on the strategic choices of the venture capital company regarding organisation, product system, and market segments. The interview's logic follows both the 'business idea' thinking and the venture capital process.

1 STRATEGY

Strategy of the first owner-type, the founder: Did it change and (if so) how and why it changed, what changed in it, and the strategy of the current owner-type.

- Were you aware of the forms of international venture capitalism, and how did these affect the choices made?
- How was the external operating environment, and how did it possibly affect the process of getting started?

1.1 Mission

- Whose initiative (to get started), which reference or interest group?
- What was the motive of the 'initiator' for the founding, how about the other founders?
- At first, whom were you set out to serve?

=> What was the mission of the venture capital company?

1.2 Organisation

- How were the choices for the company's legal form and operating principles founded and justified – did not the venture capitalist insist on protecting his role (LTD-structure leads to changes in control after additional issues of stock, i.e., new fund-raising exercises)?
- What was each party's role and objectives – whom did the whole serve in which way: The initiator (who summoned the founding meeting), controlling owner, other shareholders, management?
- How did the ownership (who owned) show in governance – in the board work? – what was the venture capitalist's role and monitoring system?
- What were the grounds for selecting and appointing the members of the management and the board of directors (qualities and characteristics)?

1.3 Product system

- How was the venture capital company set out to earn its living (in relation to mission, i.e., to what was conceived as "earning a living")?
- How were the products defined, i.e., what was being marketed (capital, management, investees, or other), i.e., what was the business you were in?
- How were the products priced?
- How did the owner monitor and participate in the 'production' process

1.4 Market segments

- To whom were you set out to sell which product?
- Whom did you think of as the customer (funders, suppliers, consumers, government, or someone else)?
- What was the most important during the first years – customer,

2 IMPLEMENTATION

Implementation (of strategy) by the first owner-type, the founder. Did it change and, if so, how and why, what changed in it, and the implementation of the current owner-type.

- Were you aware of implementation in international venture capitalism, and how did this affect the choices made?
- How did the external environment affect the implementation process?

2.1. Fund-raising

- Who performs?
- Where does the money come from and on which arguments?
- How were the funders perceived, what was the motive of their investment?
- How were the investment vehicles marketed, how did strategy show?

2.2 Entering

- Generation of deal flow – how was this pursued, under which profile?
- Screening phase – what was the 'attitude' of screening?
- What kind of businesses where pursued?
- How about due diligence?

2.3 Value-adding

- Deal structuring: size of equity stake; extent/role/style of investee-control?
- Managerial value-adding contribution: What was at the core of value adding: The parent (=the *venture capital company*, potentially making only majority investments), the daughter (=the *portfolio companies* of such venture capital firm) or the holding (=the *ownership stakes* held in investee firms)?

2.4 Exiting

- Dividend income (accrued from portfolio companies) vs. IPO vs. trade sale
- Strategic (indirect financial) vs. direct financial gains?

YHTEENVETO (FINNISH SUMMARY)

Tämän tutkimuksen tarkoituksena on lisätä venture capital -ilmiön ymmärrettävyyttä tarkastelemalla sitä *liiketoimintana – jonkun harjoittamana* liiketoimintana. Tutkimuksen kohteena ovat venture capital -yhtiöiden *omistus* ja *strategia*, niiden väliset yhteydet ja näiden muutos, joita tutkimalla tavoitellaan uutta tietoa venturekapitalismin (e. venture capitalism) dynamiikasta ja venturekapitalistin (e. venture capitalist) strategialogiikasta. Tavoitteena on edistää strategiointia sekä venture capital -yritysten sisällä että niiden ulkopuolella. Paitsi venture capital -yhtiöiden omistajat ja managerit, myös heidän sijoittajansa ja sijoituskohteensa sekä sijoituskohteiden ostajat ja talouspoliittiset päätöksentekijät tekevät venture capital -yhtiöitä koskevia strategisia päätöksiä.

Paitsi liiketoimintana, venture capital -ilmiötä voidaan lähestyä myös mm. pk-yritysten *rahoitusmuotona*, sijoittajille tarjolla olevana *sijoitusinstrumenttina*, yritysjohdon *corporate venturing -työkaluna* ja *kansantaloudellisena mekanismina*. Aiempaa tutkimusta, jossa korostuu venturekapitalistin oma näkökulma, on itse asiassa paljon vähemmän kuin tutkimusta, jossa korostuu venturekapitalistin jonkun *sidosryhmän* näkökulma. Koska aikaisempi tutkimus on kohdistunut lähinnä venture capital -yhtiöiden toiminnan vaikutuksiin ja ilmenemismuotoihin eri sidosryhmien (mm. yrittäjien) näkökulmasta, on niiden *toteutuneista strategioista* kertynyt huomattava määrä tietoa. Sen sijaan logiikasta strategioiden takana - tai edes siitä, *kenen* logiikkaa se on - on tutkimusta tehty niukasti. Keskeinen syy aukolle tutkimuksessa on venture capital -toiminnan luottamuksellisuus, jopa salaperäisyys. Alan organisaatioita on vaikea lähestyä ja avata tutkimukselle. Toisaalta toimialan tuotantoprosessit ovat hyvin pitkiä, pääomankeräysvaiheesta irtaantumisvaiheeseen saattaa kulua kymmenen vuotta. Tutkimukselliset haasteet, sisäänpääsy ja pitkäaikainen sitoutuminen, ovatkin voimakkaasti karsineet syvälliseen tutkimukseen tarttujien lukumäärää.

Ilmiönä *venture capital* onkin integroituvalle maailmantaloudelle samanaikaisesti *Graalin malja* ja *Pandoran lipas;* yhtäältä uusia kansallisia kilpailuetuja, vientituloja ja työpaikkoja synnyttävä *kansantalouden mekanismi,* toisaalta suljettu, tuntematon, *mystinen valtakeskittymä.* Koska venturekapitalisti kuitenkin on eräänlainen 'markkinatalouden lääkäri', jonka 'seerumi' (*oikein* diagnosoituna, annosteltuna ja injektoituna) suojaa kansantalouksia taloudellista jälkeenjääneisyyttä vastaan, on haluttu raottaa salaperäisyyden verhoa ilmiön yltä.

Tutkimuksessa pohditaan, *kuka* harjoittaa venture capital -liiketoimintaa, *miksi* harjoittaa ja *miten.* Tarkastelu ulottuu toimialan syntyvaiheista nykyhetkeen, Amerikasta Eurooppaan, ja kehitykseen erityisesti Suomessa. Tutkimuksessa luodaan uusi tapa lähestyä ja tutkia venturekapitalismia sekä rakennetaan venturekapitalistin strategiamaailmaa hahmottava uusi käsitteistö ja teoreettinen viitekehys. Empiirisesti tutkimus pureutuu *erilailla omistettujen* venture capital -yhtiöiden päämääriin, rakenteisiin ja strategioihin. Tutkimus on luonteeltaan eksploratiivinen ja perusteiltaan induktiivinen prosessi, joka sai alkukipinänsä tutkijan astuttua yksityisen suomalaisen kehitysyhtiökonsernin palveluk-

seen vuonna 1986. Muodollisesti tutkimusprojekti käynnistyi ekonominopintojen aineopintoseminaarissa syksyllä 1987 ja se on alusta alkaen myötäillyt tutkijan urakehitystä, joka vuonna 1993 toteutetun MBO:n jälkeen muuttui neljä vuotta kestäneeksi venture capital -yrittäjyydeksi. Tutkimuksen kohdeilmiötä on näin ollen voitu vuoden 1996 loppuun asti tarkastella *sisältäpäin*. Tutkijan osallistuminen kohdeilmiöön edistää ilmiön ymmärtämistä ja lisää tulkitsevaa tutkimusotteen validiteettia. Vastapainoksi tutkijan toiminnalle tärkeänä tutkimusinstrumenttina tutkimuksessa on toteutettu lukuisia tutkijan tulkintaa koettelevia ja ohjaavia rinnakkaistutkimuksia. Lisäksi tutkija on vuoden 1997 alusta lukien pysynyt toimialan ulkopuolella.

Metodologisesti tutkimus nojaa neljään eri lähestymistapaan ja niiden synteesiin (raportin ensimmäinen ja toinen luku johdattelevat tutkimusaiheeseen ja esittelevät tutkimusasetelman ja -strategian). *Käsitteellinen konstruointi*, jonka tavoitteena on synnyttää venturekapitalistin strategialogiikan teoreettinen viitekehys (ja jonka tulokset esitellään luvussa kolme), on luonteeltaan poikkitieteellistä ja nojaa vahvasti tutkijan omaan toimialakokemukseen vuosilta 1986-1996. *Historiallinen tarkastelu*, jonka tavoitteena on hahmotella venturekapitalistin strategialogiikan kantatyyppejä (ja jonka tulokset esitellään luvussa neljä), perustuu aiempaan kirjallisuuteen ja keskittyy erityisesti toimialan kehkeytymiseen Amerikassa. *Survey-harjoitus*, jonka tavoitteena on koetella arkkityyppien hahmottelua (ja jonka tulokset esitellään luvussa viisi), koostuu vuosina 1989, 1992 ja 1997 Suomessa ja vuonna 1992 Amerikassa toteutetuista toimialakyselyistä ja niiden tilastollisesta käsittelystä. *Case-tutkimus*, jonka tavoitteena on teoriahahmotelman syvempi koettelu (ja jonka tulokset esitellään luvussa kuusi), kohdistuu Suomen markkinoihin, erityisesti kahden venture capital -yhtiön seuraamiseen läpi omistajatyypin vaihdosten, ja se perustuu keskeisiltä osiltaan vuosina 1993, 1997 ja 2000 tehtyihin case-haastatteluihin

Venture capital -käsite ymmärretään tutkimuksessa ns. klassista näkökulmaa *laajemmin* eli *sijoituskohteen (varhaista) kehitysvaihetta* ei pidetä venture capital -yhtiön määrittelyä rajaavana tekijänä. Toisin sanoen, myös enemmistöosuuksia kypsien toimialojen yrityksistä ostavat, kehittävät ja myyvät toimijat hyväksytään venture capital -yhtiön määritelmän piiriin.

Venturekapitalismin viitekehystäminen *strategialogiikan* näkökulmasta

Venturekapitalismin uudelleenkehystämisen kannalta keskeinen havainto liittyy toiminnan perusluonteeseen, joka nähdään aiemmasta poiketen lähtökohdiltaan ennemmin *omistamisena* kuin sijoittamisena tai rahoittamisena. Venturekapitalismia itseään lähestytään *venture capital -yhtiöiden omistajien harjoittamana* toisten yritysten omistukselliseen kehittämiseen liittyvänä liiketoimintana. Venturekapitalisti määritellään siis venture capital -yhtiön enemmistöomistajaksi; tahoksi, joka *omistaa venture capital -yhtiön kontrollin* eli päätöksenteko-oikeuden. Venturekapitalisti on joko luonnollinen tai juridinen henkilö tai näiden tiimi tai ryhmä. Omistajatyypin perusteella venture capital -yhtiöt jakautuvat kolmeen pääluokkaan: *yrittäjävetoisiin*, *korporatiivisiin* ja *julkisyhteisöllisiin*. Toiminnan päämäärän perusteella ne jakautuvat kahteen pääluokkaan: *suoraa rahamääräistä*

tuottoa tavoitteleviin ja *epäsuoriin strategisiin* päämääriin pyrkiviin toimijoihin. Omistajavalvonnan näkökulmasta ne jakautuvat *yhtenäisen* ja *hajanaisen* omistajapohjan yhtiöihin.

Venturekapitalismia tutkitaan omistamiseen liittyvänä liiketoimintana käsitteellisesti *strategiatutkimuksen* näkökulmasta ja työkaluin. Näin saadaan myös uutta tietoa omistajien aktivoituneesta toiminnasta yritysten strategiatodellisuudessa. Strategia on perimältään *yksilöllistä,* (sotajoukkojen) johtajan (kenraalin) henkilökohtaista (vihollisen nujertamiseen tähtäävää) resurssien kohdistamisen taitoa ja kykyä. *Strategialogiikka* on subjektiivista, yrityksen päätöksentekijöiden (tässä: venturekapitalistien: *luonnollisten henkilöiden* tai *juridisia henkilöitä edustavien* luonnollisten henkilöiden) ajattelun logiikkaa. Liikeideatarkastelu, yksi strategialogiikan varhaisista ilmenemismuodoista, on alusta alkaen toiminut tämän tutkimuksen keskeisenä työkaluna: tavoitteena on ollut hahmottaa eroja ja yhtäläisyyksiä venture capital -yhtiöiden tuotteissa, markkinoissa ja tavassa toimia; eri aikoina ja eri ympäristöissä.

Kolmantena teoreettisena ulottuvuutena tutkimus kietoutuu (pääomankeräyksestä, sisäänmenovaiheesta, arvonlisäyksestä ja irtaantumisesta koostuvan) *venture capital -prosessin* ympärille. Tutkimus liittyy venture capital -tutkimuksen ympärillä käytävään ajankohtaiseen teoreettiseen keskusteluun, jossa pohditaan mm. venture capital -yritysten olemassaolon perusteita ja esim. sitä, ymmärtävätkö venturekapitalistit itse omaa päätöksentekoaan.

Venturekapitalistin strategialogiikan viitekehys korostaa omistuksellisia kysymyksiä: kuka omistaa venture capital -yrityksen, miksi omistaa ja miten. Ohjaavan viitekehyksen perusteella venturekapitalistin liikeidea nähdään muotoutuvan prosessista, jossa (i) organisoidutaan joko yhden osakeyhtiön toimintamallia tai useita erillisiä Ky-muotoisia rahastoja hyödyntävään liiketoimintaan, (ii) etsitään *tavarantoimittajia* ja kanavoidaan *rahoittajien* varat lupaavimpaan *yritysraaka-aineeseen,* (iii) rakennetaan aktiivisen omistajan ottein yksittäisten omistuskohteiden markkina-arvoa ja (iv) lopulta myydään omistukset osakemarkkinoiden *kuluttajille*.

Venturekapitalistityyppien ja strategialogiikan evoluutioprosessi

Vaikka venture capital -prosessin perusidea on hyvin selkeä, ovat erilaiset toimijat hyödyntäneet sitä kovin eri tavoin ja erilaisin tavoittein eri aikoina ja erilaisissa ympäristöissä. Näihin eroihin ei aiemmassa tutkimuksessa olla kuitenkaan juurikaan kiinnitetty huomiota, vaan venturekapitalisteja on lähestytty *oletustasolla* homogeenisena joukkona. Pintapuolisesti tarkastellen suurimmat eroavaisuudet noteerataan kohdeyrityksiin liittyvissä valinnoissa - suhteessa preferoituun kehitysvaiheeseen, toimialaan, kotipaikkaan ja omistusosuuden suuruuteen - tai venturekapitalistien määrälliseen aktiivisuuteen arvonlisäystyössä. Eroavaisuudet venturekapitalistien perimmäisissä motiiveissa ja liiketoiminnallisissa tavoitteissa ovat jääneet huomattavasti vähemmälle huomiolle.

Erilaiset venturekapitalistit ovat liikkeellä erisuuruisin pääomin ja hyvinkin erilaisin tavoittein. Heidän taustansa ja suhteensa toimintansa rahoittajiin vaihtelee myös melkoisesti. Venturekapitalismin kansallisiin muotoihin (toimi-

joihin, tavoitteisiin, tekemiseen, tuloksiin) vaikuttaa keskeisesti maan toimintaympäristö. Niinpä toiminta saa eri muotoja eri maissa eri aikoina. Espanjan kuningatar Isabellan rahoittajalleen kuningas Ferdinandille puoltamaa sijoitusta italialaisen Kristoffer Kolumbuksen *Intian purjehdukseen* voidaan pitää ensimmäisenä tunnettuna *pääomasijoituksena.* On tärkeää tiedostaa, että mm. Portugalin kuningashuone oli aiemmin tehnyt hankkeen suhteen *kielteisen sijoituspäätöksen.* Jokainen venturekapitalisti (i) panostaa *parhaaksi katsomiinsa* yrityshankkeisiin, (ii) osallistuu niissä *parhaaksi katsomillaan tavoilla* arvonnousun aikaansaamiseen ja (iii) pyrkii ajan myötä realisoimaan sijoituksilleen *tavoittelemansa sisältöisen* tuoton. Onkin tärkeää pohtia *kuka* itse asiassa on pääomasijoittaja, ymmärtää *miksi* hän on olemassa ja *miten* hän leipänsä ansaitsee.

Varakkaat suvut ja liikemiehet, pääomanomistajat *(e. capitalists),* lähtivät ensimmäisinä *ammattimaisesti* - omilla varoillaan - ulkopuolisina omistajina kehittämään yrittäjävetoisia, usein aloittavia yrityshankkeita *(e. venture).* Ensimmäinen tunnettu venture capital -yhtiö oli John Whitneyn vuonna 1946 perustama *yksityishenkilövetoinen* J. H. Whitney & Co. Myöhemmin samana vuonna perustettiin myös alan ensimmäinen *institutionaalinen* yhtiö, American Research and Development Corporation (ARD), jonka omistus oli (pörssiyhtiönä) tarkoitettu laajenevalle sijoittajajoukolle ja management palkkajohtajille. Legendaarisen kenraali Georges Doriotin lähes kolmen vuosikymmenen ajan johtaman ARD:n lanseeraamaa yhden osakeyhtiön toimintamallia voidaan pitää *julkisyhteisöllisen* eurooppalaisen venturekapitalismin esikuvana. Seuraava uuden toimialan merkkivuosi oli 1958, jolloin lanseerattu SBIC-ohjelma teki mahdolliseksi perustaa venture capital -yhtiöitä valtiollisen pääoman avulla. Vaikka ohjelma sai liikkeelle myös systeemin väärinkäyttäjiä, voidaan sitä pitää toimialan lopullisesti vakiinnuttaneena tekijänä, jonka mukanaantuoman vipuelementin myötä venture capital -yhtiöstä *itsestään* tuli business.

ARD:n edustaman *yhden Oy:n toimintamallin* rinnalla toimialan voimistuminen jatkui erillisiä määräaikaisia Ky-muotoisia rahastoja hyödyntäen (erityisesti vuoden 1978 jälkeen, jolloin eläkesäätiöiden osallistuminen *sijoittajana* venture capital -yhtiöiden toimintaan tehtiin lainsäädännöllisesti mahdolliseksi). Esikuvana oli vuonna 1965 perustetun Greylock & Co.:n ('ARD:n kasvattien') kehittelemä *limited partnership* -muotoinen rahastomalli, jossa yksittäiset venturekapitalistit toimivat henkilökohtaisesti ja/tai omistamiensa osakeyhtiöiden kautta vastuullisina yhtiömiehinä (e. general partners) ja sijoittajat äänettöminä yhtiömiehinä (e. limited partners). Tällaisissa venture capital -yhteisöissä sijoittajat pitäytyivät täysin passiivisina säilyttääkseen mm. pääomapanokseen rajatun riskin ja edullisemman verokohtelun. Yhtenä pontimena Ky-muotoisen rahastorakenteen synnylle olivat sen mahdollistama *venturekapitalistin yrittäjätulo,* josta ARD:n palkkajohtajat olivat jääneet paitsi, ja *rahaston rajattu elinikä,* jonka oleellisuudesta venture capital -toiminnan dynamiikassa mm. ARD:n oma fuusioon Textronin kanssa päättynyt elämä todistaa. Muun muassa erillisiin Ky-rahastoihin perustuvan toimintamallin ansiosta venture capital -toimiala kehittyi Amerikassa dynamiikaltaan ja kulttuuriltaan vahvasti *yksityishenkilövetoiseksi* – ei institutionaaliseksi kuten Euroopassa.

Venturekapitalistien varhaiset ansiot uudella mantereella saivat aikaan kiinnostuksen venture capital -prosessin kansantaloudellisiin vaikutuksiin myös muualla. Niinpä 1960-luvusta lähtien hallitukset eri puolilla maailmaa perustivat paikallisia ARD-yhtiöitä tuottamaan paikallisia *Appleja* ja *FedExejä* eli vauhdittamaan talouskasvua ja synnyttämään uusia työpaikkoja. Lisäksi ne kehittelivät erilaisia kannustimia yksityisen pääoman saamiseksi mukaan toimialalle. Venture capital -prosessi tuotiin Eurooppaan paljolti valtiollisten tahojen toimesta juuri kansantalouden kehitysmekanismiksi. Venture capital -prosessin hyödyntäminen levisi nopeasti myös alue- ja kuntatasolle. Esimerkiksi kaikissa Pohjoismaissa erilaisten julkisyhteisöjen hallinnoimat venture capital -yhtiöt olivat 1990-luvun loppupuolelle asti paitsi perinteinen, myös keskeinen toimija. Julkisen sektorin toimijoiden lisäksi myös suuryritykset löysivät 1960-luvulla venture capital -prosessin kiinteäksi osaksi corporate venturing -toimintaansa.

Venturekapitalistin sukupuu: tyvestä puuhun, puuta alas - ja takaisin

Institutionalisoituminen, venture capital -toimialan keskeinen kehitystrendi, viittaa paitsi toimialan yritysten omistuspohjan (ja venturekapitalistin sukupuun) *laajentumiskehitykseen* (ääriesimerkkinä julkisyhteisöjen omistamat ja julkisesti noteeratut venture capital -yhtiöt), myös tiettyihin toimialan orgaaniseen kasvuun liittyviin piirteisiin. Yhden rahaston taloudellinen menestys johtaa lähes lainmukaisesti uuden, aiempaa suuremman rahaston perustamiseen, mikä puolestaan kasvattaa minisijoituksen markkamäärää. Menestyksen myötä venture capital -prosessi muuttuu *venture capital -spiraaliksi,* joka määritelmänmukaisesti ohjaa toimialan yrityksiä keskittymään koko ajan suurempiin sijoituskohteisiin, mikä puolestaan synnyttää pääoma-aukon (e. capital gap) yritysprosessin alkupäähän, jossa näin ollen on koko ajan kysyntää uusille venture capital -toimijoille, joiden syntyä tosin haittaa sijoittajien (absoluuttisesti) yhä suurempiin rahastoihin ja siten (suhteellisesti) yhä pienempiin hallinnointipalkkioihin suuntautuva kysyntä. Paitsi rahastojen (ja sen myötä yksittäisten minimisijoitusten) kasvava koko, myös mm. Euroopan yhdentymisprosessi (joka ohjaa suuriin yritysjärjestelyihin) painavat toimialan määrällistä painopistettä yhä kypsempien toimialojen, teknologioiden ja liiketoimintakonseptien suuntaan. Toisaalta *uuden talouden* ja IT-sektorin yrityshankkeet ovat luoneet uutta, *riittävän pääomaintensiivistä* kysyntää myös alkavaan yritystoimintaan.

Omistajatyypin perusteella venture capital -yhtiöt jakautuvat yksityishenkilövetoisiin ja institutionaalisiin yrityksiin. Yksityishenkilövetoiset venture capital -yhtiöt puolestaan jakautuvat yksityishenkilöomisteisiin yhtiöihin, joissa ei ole ulkopuolisia sijoittajia, ja yrittäjävetoisiin yhtiöihin, joissa toimiva johto (partnerit) omistavat kontrollin ja joihin toimintaa rahoittavat tahot osallistuvat ulkopuolisen sijoittajan roolissa. Institutionaaliset venture capital -yhtiöt jakautuvat korporatiivisiin (joko itsenäisiin tai epäitsenäisiin) ja julkisyhteisöllisiin (joko valtiollisiin tai alueellisiin) yhtiöihin. Itsenäiset korporatiiviset venture capital -yhtiöt ovat usein julkisesti noteerattuja, joten venturekapitalistin identifioiminen on niissä korostetun vaikeaa. Epäitsenäiset (e. captive) korporatiiviset yhtiöt ovat useimmiten yhden suuren joko teollisen tai rahoitusalan yrityk-

sen kokonaan omistamia tytäryrityksiä. Siinä missä toimialan kehityskaari on Amerikassa noudatellut useimmille toimialoille ominaista asteittaista omistuspohjan laajentumiskehitystä – kapuamista *puuta ylös* – on se Euroopassa, erityisesti Suomessa ollut (ainakin toistaiseksi) kapuamista *puuta alas.*

Suomeen venture capital -prosessin toi 1960-luvulla Suomen Pankki. Se omisti enemmistön Sponsor Oy:n, Suomen ensimmäisen venture capital -yhtiön, osakepääomasta vuosina 1967-1983. Motiivina Sponsorin perustamiselle ei ollut niinkään havainto hyvätuottoisesta liiketoiminnasta sinänsä, vaan liikeidean erinomaisista kansantaloudellisista sivuvaikutuksista. Vastaavin tavoittein ja metodein venturekapitalismi käynnistyi Suomen lisäksi mm. Ruotsissa. Kuvaavasti meillä omaksuttiin venturekapitalistia vastaavaksi toimialan keskeistä toimijaa kuvaavaksi käsitteeksi *kehitysyhtiö.* Vaikka kyseessä oli suora käännös Ruotsissa käyttöönotetusta termistä *utvecklingsbolag,* sopi se varmasti muutenkin (mm. poliittisesti) ajan henkeen paremmin kuin mikään suora käännös käsitteelle *venture capitalist.* Nykyinen *pääomasijoitusyhtiön* käsite on sukua lähinnä *private equity* -käsitteelle, jota Euroopassa *venture capital* -käsitteen sijasta toimialan yleisnimityksenä nykyisin suositaan.

Asia ei ole käsitesisällön puolesta aivan vähäpätöinen, sillä käsitteeseen *venture capitalist* liittyy koko ilmiön ymmärtämisen kannalta tärkeä ulottuvuus. Toimialan legendat, suuret menestystarinat, ovat perustuneet pääasiassa *riippumattomien venture capital -yrittäjien* (ei kasvottomien instituutioiden) tekemisiin. Venture capital -toiminnan dynamiikka (itsenäisten yritysten luominen ja listaaminen pörssiin) on siis edellyttänyt venturekapitalisteilta itseltäänkin *riippumattomuutta* ja *yrittäjyyttä (valtaa ja vastuuta),* mikäli toiminnan tavoitteena on ollut voitontuotto klassisessa mielessä. Venture capital -yhtiöiden ammattilaiset ovat Euroopassa pääsääntöisesti olleet palkattuja yritysjohtajia - eivät itsenäisiä yrittäjiä, kuten Amerikassa. Euroopassa venturekapitalistin ja yrittäjän välisessä kanssakäymisessä on vallinnut lähinnä *instituutio-yrittäjä* -asetelma, Amerikassa puolestaan *yrittäjä-yrittäjä* -asetelma. Amerikassa venturekapitalistilla on *kasvot,* Euroopassa venturekapitalisti on perinteisesti ollut *kasvoton korporaatio.*

Suomessa yleisin toimintamalli oli pitkään yhden osakeyhtiön rakenne, jossa pääomankeräys tapahtuu osakepääomaan korotuksina. Viime vuosien aikana on erillisten rahastojen hallinnointiin perustuva toimintamalli tosin noussut valta-asemaan myös Suomessa. Yhden osakeyhtiön toimintamallissa on yhtiön kulloinenkin enemmistöomistaja venturekapitalistin roolissa (juridisten henkilöiden tapauksessa hallitusedustajiensa välityksellä). Venture capital -yhtiö on tällöin useimmiten *institutionaalinen,* joko *korporatiivinen* tai *julkisyhteisöllinen.* Suomalaisessa traditiossa pääomanomistajien edustajat osallistuvat usein aktiivisesti päätöksentekoon myös ky-muotoisissa venture capital -rahastoissa. Niiden edustajat istuvat sijoittajaneuvostoissa, jotka asemaltaan usein käytännössä vastaavat osakeyhtiön hallitusta. Tällöin rahoittajat ottavat käytännössä itse vastuun koko liiketoiminnan harjoittamisesta ja toimivat venturekapitalistina nimeämänsä hallituksen välityksellä myös Ky-rakenteissa.

Yhden osakeyhtiön toimintamallissa, jossa uusia sijoittajia otetaan mukaan suunnatuilla tai yleisillä osakeanneilla, laajenee venture capital -yhtiön omistajapohja koko ajan ja sekä venturekapitalisti että koko omistajatyyppi saattaa

vaihtua joko ennalta suunniteltujen tai suunnittelemattomien osakekauppojen seurauksena. Tästä todistaa myös mm. Sponsor Oy:n yli 30-vuotinen historia, jonka aikana yhtiö on kokenut kaikki omistajatyypit. Suomen ensimmäisen yksityishenkilövetoisen venture capital -yhtiön, Mancon Oy:n kehityskaari perustamisesta vuonna 1978 konkurssiin vuonna 1989 kertoo yhtäältä *yhden osakeyhtiön toimintamallin* toisaalta *pörssilistauksen* aiheuttamista erityisistä haasteista venture capital -yritykselle. Näiden lisäksi Manconin tarina alleviivaa (laajasti ymmärrettynä) toimintaympäristön ja valtiollisten toimialaan kohdistuvien kehitystoimien merkitystä menestykselliselle venture capital -toiminnalle.

Erillisiin Ky-rahastoihin perustuvan toimintamallin suomalainen pioneeri, CapMan Capital Management Oy, perustettiin myös aikanaan (1988) ennemmin korporaatioiden strategiseksi työkaluksi kuin lupaavan uuden liikeidean toteuttajaksi. Vuonna 1993 yhtiössä toimeenpantu johdon yritysosto teki CapManista kuitenkin Suomen ensimmäisen yrittäjävetoisen, Ky-rahastojen hallinnointiin perustuvan toimintamallin venture capital -yhtiön. Vuosina 1993-1997 maaperä alkoi kypsyä yrittäjävetoisuuden hyväksymiselle laajemminkin ja vuonna 1997 julkisyhteisöllinen SFK Finance Oy ja korporatiivinen Sponsor Oy muuttuivat yrittäjävetoisiksi johdon yritysostojärjestelyjen seurauksena.

Vaikka kehitysyhtiöiden aikakautta seurannut venturekapitalistien 'uusi tuleminen' ja siihen liittyvä siirtyminen yrittäjävetoisiin toimintamalleihin on vielä suurelta osaltaan käynnissä, siintää 'kolmas tuleminen' jo horisontissa. Kun yrityksen omistus ja kontrolli on kokonaisuudessaan toimivalla johdolla ja yritystoiminnassa on alettu saavuttaa huomattavaa orgaanista kasvua ja siihen liittyvää taloudellista menestystä, alkaa tällaiseen yhtiöön vaikuttaa yritystoiminnalle luontainen, omistuspohjan laajentamiseksi toimiva vetovoima. Sama luonnonvoima vaikuttaa myös venture capital -toimialalla. CapMan on jo ehtinyt julkaista suunnitelmansa järjestelyistä, joiden perusteella se listautuu Helsingin arvopaperipörssiin keväällä 2001.

Venturekapitalistin strategialogiikan arkkityypit ja *omistajan* professio

Aiemmassa venture capital -tutkimuksessa toimialaa on käsitelty pääasiassa homogeenisena osana pääomamarkkinoita painottaen milloin yrittäjien, milloin sijoittajien, milloin suuryritysten, milloin valtiovallan näkökulmaa ja tavoitteita ymmärtää ja hyödyntää venture capital -prosessia. Tässä tutkimuksessa ilmiötä on lähestytty liiketoimintana. Sen perusteella venturekapitalismi on perimältään ennemminkin *omistamista* kuin sijoittamista tai rahoittamista ja venturekapitalisti vastaavasti perimältään ennemminkin *omistaja* kuin sijoittaja tai rahoittaja. Joidenkin venturekapitalistien toiminnassa omistaminen ja omistajana toimiminen kuitenkin korostuu enemmän kuin joidenkin toisten.

Venturekapitalistin olemukseen ja tunnistamiseen ei ole aiemmin kiinnitetty suurta huomiota. Tässä tutkimuksessa venturekapitalisti on tullut määritellyksi venture capital -yhtiön enemmistöomistajaksi ja omistuksella sinänsä (sillä *kuka* omistaa, *miksi* ja *miten*) on sekä survey- että case-tutkimusten perusteella todettu olevan merkitystä strategialogiikkaa muovaavana tekijänä.

Venture capital -yhtiöiden on todettu olevan olemassa omistajiensa, venturekapitalistien, päämäärien ajamiseksi. On voitu todeta, että kaikki venture capital -yritykset eivät suinkaan ansaitse elantoaan 'samassa kohdassa' venture capital -prosessia. Tutkimuksessa hahmotellaan yhteensä kuusi erilaista venturekapitalistin strategialogiikan arkkityyppiä:

(i) *varainhoitajien* strategialogiikassa korostuu pääomakeräysvaihe ja rahastojen hallinnointi; päätuotteiksi koetaan rahastot ja tärkeimmiksi asiakkaiksi niihin sijoittavat sijoittajat,

(ii) *venturepankkiirien* strategialogiikassa korostuu pääoman myyminen sisääntulovaiheessa; päätuotteeksi koetaan raha ja asiakkaiksi sitä ostavat yrittäjät ja yritykset,

(iii) *imperiuminrakentajat* hankkivat uusia sijoittajia että uusia sijoituskohteita käytännössä pysyviksi osiksi elämäänsä; päätuotteeksi koetaan yhtiö itse ja asiakkaiksi sen piiriin tavoiteltavat uudet sijoittajat ja yrittäjät,

(iv) *palkkionmetsästäjien* toiminnassa korostuvat emokonsernien strategiset tavoitteet; päätuotteeksi koetaan rahan lisäksi toimialaosaaminen, jonka varassa uusia innovaatioita kalastetaan tulevaisuuden rakennusaineeksi,

(v) *huolenpitäjien* toiminnassa korostuu sosiaalinen vastuu ja uusien työpaikkojen luominen; päätuotteeksi koetaan yhtiön resurssit ja asiakkaiksi yrittäjät, mutta arvonlisäystoiminnalla on selkeää itseisarvoista merkitystä,

(vi) *ammattiomistajat* toimivat omistajan valtakirjalla yritysten omistuksellisen arvon korjaajana; päätuotteina korostuvat myyntikuntoon saatetut omistuskohdeyritykset ja asiakkaina osakemarkkinoiden kuluttajat.

Tutkimuksessa synnytetty venturekapitalistin strategialogiikan teoreettinen viitekehys, jota hyödyntäen eri arkkityyppien ominaispiirteitä on ollut mahdollista havainnollistaa ja alleviivata, on konkreettinen strategiatyökalu ja sellaisenaan käyttökelpoinen paitsi venturekapitalistien omassa strategioinnissa, myös heidän eri sidosryhmiensä toimialaa koskevassa päätöksenteossa. Tutkimus nostaa esiin venture capital -prosessin unohdetun keskeisen sidosryhmän: venturekapitalistien omistuskohdeyritysten ostajat eli osakemarkkinoiden kuluttajat, jotka ovat pääsääntöisesti joko listautumisanneissa osakkeita ostavia pörssisijoittajia tai teollisia yritysostajia. Venture capital -toiminnan institutionalisoitumiseen liittyvää dynamiikkaa havainnollistetaan kuvaamalla venture capital -prosessin muutos venture capital -spriraaliksi.

Tutkimuksen syvän käsiteanalyyttinen ote ohjaa pohdintaa yrityksen teorian (e. theory of the firm) alueelle; kehittelemään omistaja- ja yrittäjäkeskeistä ajattelua *sidosryhmäkeskeisen* ja *osakkeenomistajakeskeisen* ajattelun rinnalle. Ehdotukset jatkotutkimuksen suunniksi ja kohteiksi tulevatkin tässä tutkimuksessa puetuiksi uuden teoriahahmotelman ja -suuntaviittojen muotoon. Venturekapitalismissa nähdään kulminoituvan *omistusjohtajan* profession synty, erotuksena *sijoitusjohtajalle* ja *yritysjohtajalle*, ja jatkotutkimuksen suhteen toivotaan perehdyttävän erityisesti sijoittajan ja omistajan roolien keskinäiseen suhteeseen ja sen vaikutuksiin johtajan työhön.

Suomalainen venturekapitalistikenttä on selvässä liikkeessä kohti yrittäjävetoisia hallinnointirakenteita ja suoraan rahassa mitattavissa olevia tuottota-

voitteita. Hajanainen omistajapohja on selvimmin tullut tiensä päähän. Toistaiseksi. Strategisiin päämääriin pyrkiviä venturing-yhtiöitä käytetään täsmäaseina edelleenkin niin julkisyhteisöjen kuin yksityisten korporaatioidenkin toimesta. Julkisyhteisön, joka päättää hyödyntää venture capital -prosessia elinkeinopolitiikan välineenä, on kuitenkin tarkkaan tunnettava ja tunnustettava realiteetit. Venture capital -toiminnan kohteena olevien kasvuyrittäjien *(tulevien vallanpitäjien)* yrityshankkeiden 'vallankumouksellisesta' luonteesta johtuen eri toimenpiteiden hyväksyttäminen pitkässä linjassa *nykyisten vallanpitäjien* eli suurten institutionaalisten sijoittajien ja suurteollisuuden edustajien kanssa ei ole omiaan edistämään venture capital -yhtiön toimivan johdon ja kasvuyrittäjien keskinäistä luottamusta ja yhteistyötä. Asioiden sopiminen ja hoitaminen yrittäjien kesken on omiaan murtamaan padot, mutta asetelmaan pääseminen edellyttää paitsi poliittista tahtoa ja pääomasijoittajien henkilökohtaista riskinottokykyä, myös *oikeita* toimenpiteitä.

Kaikkialla Euroopassa uskotaan nykyään *yksityisyrittäjyyden* voimaan. Ei ole enää epäselvää etteivätkö voimakkaat, menestysnälkäiset yrittäjäpersoonat ole kansantalouden kilpailukyvyn ja elinvoimaisuuden kannalta mittaamattoman arvokkaita luonnonvaroja. Aivan kuten huippu-urheilussa, ns. pienten marginaalien lajeissa, kaikki on lopulta kiinni, paitsi taidosta ja onnesta, myös *yksilöjen tahdonvoimasta,* jonka yrittäjyys jalostaa huippuunsa. Kansantalouksien haasteena on tämän tahdonvoiman paikallistaminen, voimistaminen ja valjastaminen mahdollisimman arvostettujen ja elinvoimaisten yritysten rakennustyöhön. Neuvostoliiton ja kommunismin luhistuttua on *venturekapitalismi* noussut yhä laajemmin tunnustetuksi moottoriksi tässä prosessissa. Vaikka toisen maailmansodan päättymisestä lähtien Amerikassa menestystarinoita tuottanut *venture capital* -prosessi tuotiin Eurooppaan jo 1960-luvulla, on eurooppalainen toimintaympäristö vasta 1990-luvun aikana kehittynyt vastaavan menestyksen edellyttämälle tasolle. Euroopan Unionin laajentumis- ja tiivistymisprosessi, erityisesti hiljattain lanseerattu uusi yhteinen valuutta, on synnyttämässä myös Eurooppaan sellaisen suuren yhteismarkkinan, jollainen on Amerikassa jo vuosikymmenien ajan tuottanut huikeita kasvuyritysten menestystarinoita. Venturekapitalistien olemus ja liiketoiminnallinen dynamiikka ovat kuitenkin kuluneiden vuosikymmenten aikana kokeneet sellaisen kehityksen, muutoksen ja moninaistumisen, jonka ymmärtäminen on välttämätöntä realististen sidosryhmäodotusten synnyttämiseksi.

Venturekapitalismi itsessään on syntylähteillään Amerikassa myös perinteisesti perustunut yrittäjyyteen. Onkin ymmärrettävä, että siinä on kyse kansantaloudellisesta mekanismista, joka on mitä suurimmassa määrin *liiketoimintaa,* ja jonka tavoitteiden tulisi olla yhtä suoraviivaisia ja johtamisen yhtä yrittäjämäistä – vapauksineen ja vastuineen, keppeineen ja porkkanoineen – kuin sen rahoittaman yritystoiminnankin. Yrittäjän merkitystä yrittäjyydelle ei kukaan kiistä. Venturekapitalistin merkitys venturekapitalismille ei ole yhtään pienempi. Samaa voidaan sanoa omistajan merkityksestä yritystoiminnalle yleisemminkin. Kenties juuri tämän näkökulman ymmärtämisessä, hyväksymisessä ja hyödyntämisessä piilee avain menestyskerrointen parantamiseen kestävän uuden liiketoiminnan rakennustyössä myös vanhalla mantereella.