



**KTH Architecture and
the Built Environment**

Centre for Banking and Finance
Real Estate Development and Financial Services

Thesis no. 271
Master of Science, 30 credits

Venture Capital

- The Current State of the Swedish Market

Authors:
Kristofer Makomaski
Mikael Johansson

Supervisor:
Björn Berggren

Stockholm 2013

Master of Science thesis

Title	Venture Capital -The Current State of the Swedish Market
Authors	Kristofer Makomaski and Mikael Johansson
Department	Centre for Banking and Finance
Master Thesis Number	271
Supervisor	Björn Berggren
Keywords:	Venture Capital, Private Equity, Evergreen, Limited Partnership, Business Angel, Equity gap

Abstract

During the last years the Venture Capital industry has faced several significant problems, and as for every industry crashes come and go. In the Swedish VC-industry it has been observed that every tenth year there is a “cleansing” in the market, and every fifth year a minor crash hit the market. The Swedish VC industry has decrease by over 60% since the Dotcom-crash. The numbers of VC-firms has also shrunk from between 100-200 to only 5-10 larger VC-firms. Comparing today’s market with the market before the Dotcom-crash, there were significantly more active firms within the Swedish VC-industry. New financing structures have taken place in the Venture Capital market such as Evergreen funds and crowd-funding.

The Swedish Venture Capital actors have historically taken a higher risk-level than what is actually motivated. Syndicated investments are being made to avoid individual investor risk. This phenomenon can be illustrated by two very successful Swedish investments, Spotify and iZettle.

The VC market has been characterized by legal obstacles which have created several great problems. However there are some positive legal trends happening currently in the market and will be highlighted during the thesis. It has recently been discussed to introduce an investment deduction which may be beneficial for the VC-companies.

This paper focuses mainly on the different financing structures and actors within the Venture Capital industry. Focus lies on the current development and trends of the industry, but also on its potential future. The study is based on interviews with market professionals and existing research and gives a good insight into the Swedish Venture Capital industry.

Acknowledgement

We would like to thank our supervisor Björn Berggren, for his guidance throughout the entire writing-process and for sharing his knowledge within this area.

We would also thank Marta Sjögren, Jonas Rahm, Martin Falkenvall, Peter Nilsson, Henrik Talborn, Cathrine Åskling and Daniel Katzenellenbogen which have given us their time to personally meet us and answer our interview questions.

Further thanks to Lennart Ohlsson at CEFIN (Centre for Banking and Finance) that gave us inspiration and valuable thoughts within the topic of study, which has made it easier for us to formulate a current and interesting research questions.

Finally we would like to thank David Sonnek at SEB Venture Capital which has acted as an informal supervisor during the whole process. David has a great network of contacts which have been of great value for getting us in touch with the market actors.

We appreciate all the help we have received from the different parties which have made this thesis feasible. Hopefully, this study will provide and form a basis for better understanding in what direction the industry is heading.

Stockholm, June 7th, 2013
Mikael Johansson och Kristofer Makomaski

Examensarbete

Titel	Venture Capital – The Current State of the Swedish Market
Författare	Kristofer Makomaski och Mikael Johansson
Institution	Centrum för Bank och Finans
Examensarbete nummer	271
Handledare	Björn Berggren
Nyckelord	Venture Capital, Private Equity, Evergreen, Limited Partnership, Business Angel, Equity gap.

Sammanfattning

Under de senaste åren har risk kapitalmarknaderna stått inför flera signifikanta problem. Den svenska VC industrin har minskat med över 60 % sedan Dotcom-kraschen. Antalet aktiva VC-företag har minskat i antal från 100-200 till endast 5-10 större VC-företag. Jämför man dagens marknad med hur den såg ut innan Dotcom-kraschen, så fanns det betydligt fler aktiva företag inom den svenska VC-industrin. Nya finansieringsformer har trätt in på marknaden som bland annat Evergreen fonder och crowd-funding. Den svenska VC-industrin har kännetecknats av en "rensning" av marknaden var tionde år, och var femte år uppstår en mindre krasch på marknaden.

De svenska riskkapitalaktörerna har tagit en högre risk än vad som faktiskt var motiverat. Syndikatinvesteringar görs för att undvika investerarnas enskilda risk. Detta fenomen kan illustreras genom de två lyckosamma Svenska investeringarna, Spotify och iZettle.

Riskkapitalmarknaden har varit karakteriserad av legala hinder vilket skapat flera stora problem. Trots detta finns det positiva trender och förändringar som idag genomförs på marknaden. Detta kommer lyfts fram ytterligare i arbetet. Bland annat har det diskuterats att införa ett skatteavdrag vilket anses vara fördelaktigt för riskkapitalbolagen.

Detta arbete fokuserar huvudsakligen på de olika finansieringsformerna och de olika marknadsaktörerna. Fokus ligger på utvecklingen av industrin och dess aktuella trender, men även på den kommande framtiden. Studien är baserad på intervjuer med marknadsaktörer och på befintlig forskning vilket ger en god insikt i den Svenska riskkapitalbranschen.

Förord

Vi vill tacka vår handledare Björn Berggren, som har väglett oss genom avhandlingens arbetsprocessen och delgivit sina kunskaper inom området.

Vi vill också tacka Marta Sjögren, Jonas Rahm, Martin Falkenvall, Peter Nilsson, Henrik Talborn, Cathrine Åskling och Daniel Katzenellenbogen för att de tog sig tid för att träffa oss personligen och besvara våra intervjufrågor.

Ytterligare tack till Lennart Ohlsson på CEFIN (Centrum För Bank och Finans) som har givit oss inspiration och försett oss med värdefulla tankar om ämnet som har underlättat för att formulera en aktuell och intressant frågeställning.

Slutligen vill vi tacka David Sonnek på SEB Venture Capital som har varit en informell handledare under arbetets gång. David har ett stort kontaktnätverk som har varit till stor hjälp för att komma kontakt med de olika aktörerna i branschen.

Vi uppskattar all den hjälp vi har fått från alla parter vilket har gjort denna avhandling genomförbar. Förhoppningsvis kommer denna avhandling att ge en bättre bild av den svenska riskkapital marknaden och ge en bättre förståelse i vilken riktning industrin är på väg.

Stockholm, den 7e juni, 2013

Mikael Johansson och Kristofer Makomaski

1.INTRODUCTION	8
1.1 INTRODUCTION	8
1.2 OBJECTIVE AND PURPOSE	9
1.3 RESEARCH QUESTIONS	10
1.4 LIMITATION	11
1.5 BACKGROUND	11
1.5.1 DEFINITION OF THE VENTURE CAPITAL INDUSTRY	11
1.5.2 THE HISTORY AND DEVELOPMENT OF THE VC INDUSTRY	13
1.5.3 THE CURRENT STATE OF VENTURE CAPITAL	15
2. METHOD	17
2.1 CHOICE OF METHOD	17
2.1.1 <i>RESEARCH DESIGN</i>	17
2.2 DATA COLLECTION	17
2.3 THE CREDIBILITY OF THE STUDY	19
2.3.1 <i>RELIABILITY</i>	19
2.3.2 <i>VALIDITY</i>	19
2.3.3 <i>REPLICABILITY</i>	19
2.3.4 <i>SELECTION BIAS</i>	19
2.4 DIVISION OF WORKLOAD	20
3. FINANCING STRUCTURES, THEORIES	21
3.1 VENTURE CAPITAL AND THE COMPANY FUNDING CHAIN	21
3.1.1 <i>SEED PHASE</i>	21
3.1.2 <i>START-UP PHASE</i>	21
3.1.3 <i>EXPANSION PHASE</i>	21
3.2 INVESTORS	23
3.2.1 <i>BUSINESS ANGELS</i>	23
3.2.2 <i>BUSINESS ANGELS NETWORKS</i>	24
3.2.3 <i>FAMILY OFFICES</i>	24
3.3 INVESTMENT RELATIONSHIP PROCESS	26
3.3.1 <i>DISCOVERING NEW DEALS</i>	26
3.4 FINANCING STRUCTURES	27
3.4.1 <i>LIMITED PARTNERSHIP</i>	27
3.4.2 <i>EVERGREEN FUNDS</i>	29
3.4.3 <i>CROWD FUNDING</i>	30
3.5 THE CRITERIA OF VENTURE CAPITAL INVESTMENTS	31
3.5.1 <i>EVALUATION OF INVESTMENT</i>	31
3.5.2 <i>VALUATION OF THE FIRM</i>	31
	6

3.5.3 <i>CONTRACTING</i>	33
3.5.4 <i>FINANCIAL STRUCTURE</i>	34
3.6.1 <i>ADVERSE SELECTION</i>	37
3.6.2 <i>MORAL HAZARD</i>	37
4.EMPIRICAL STUDY	39
<hr/>	
4.1 INTERVIEW RESULTS	39
4.1.1 <i>MARKET OVERVIEW</i>	39
4.1.2 <i>INVESTMENTS AND STRATEGIES</i>	39
4.1.3 <i>THE DEVELOPMENT OF THE INDUSTRY</i>	41
4.1.4 <i>INVESTMENT CRITERIA</i>	45
4.1.5 <i>RISK AVERSION</i>	45
4.1.6 <i>THE LOGIC BEHIND USING DIFFERENT INVESTMENT STRUCTURES</i>	46
4.1.7 <i>SYNDICATED INVESTMENTS</i>	49
5. ANALYSIS AND SUMMARY OF FINDINGS	51
<hr/>	
5.1. <i>EQUITY GAP</i>	51
5.2. <i>FUTURE INDUSTRY DEVELOPMENT</i>	52
5.3. <i>ECONOMIC CONSEQUENCES</i>	53
6. CONCLUSION	54
<hr/>	
6.BIBLIOGRAPHY	56
<hr/>	
6.1 WRITTEN SOURCES	56
6.2 VERBAL SOURCES	60
6.3 WEB BASED SOURCES	60
6.4 OTHER NON-REFERRED SOURCES	61
7.APPENDIX	62
<hr/>	
7.1 INTERVIEW QUESTIONS - SWEDISH	62
7.2 INTERVIEW QUESTIONS - ENGLISH	64

1.Introduction

1.1 Introduction

Sweden is like many other countries in a declining economy with rising unemployment (Konjunkturinstitutet, 2012). One way to achieve growth and reduce unemployment is to encourage innovation and try to commercialize good ideas into products (Movin, S, Plogner, A 2012). Based on the development of the economy different policy makers, actors and researchers are trying to find different methods for stimulating entrepreneurship. What usually prevents an idea to be taken all the way to production is the financing issue. This is why the politicians and other decision-makers put much effort regarding this issue (Regeringskansliet, 2012).

The Venture Capital (VC) industry has historically been very important worldwide for providing young firms with equity financing, reducing the need of debt, and not the least in Sweden. The VC firms have not only provided financing but also networks and knowledge for their portfolio firms. This has been a very promising and profitable industry over the last decades, until now. It is since the beginning of the 21th century after the Dotcom-bubble that the direction of the industry took turn, and could now be considered experiencing a crisis (Söderblom, 2012).

Over the last years the VC industry has been associated with several problems. The problems are almost the same worldwide, but in some countries the problems have started to significantly affect the industry. In Sweden the VC industry has decreased by over 60 % during the last decade. The early stage VC market has failed to attract capital, whereas other high risk markets have not. The VC industry is characterized by creating poor returns, very far below expectations. There are several problems especially within the early stage VC market, and one critical problem is the lack of available capital. The lack of capital can be associated with the poor returns in the industry. This has resulted that many institutional investors have fled the market, which has simply changed the flow of capital to more attractive markets (Söderblom, 2012).

Business Angels and VC funds usually invest in smaller portfolio objects, which mean that they have a higher demand on the precision when it comes to the investment decision. In addition,

VC companies also have a higher demand on the commitment and the involvement for the management of their portfolio objects (Söderblom, 2012).

The situation of the VC market is remarkable because of the level of uncertainty of what is going to happen next. There are different assumptions of what is going on in the market, where some claim that this is a part of the natural evolution within the industry, and other claim that the current model of the VC industry is broken and needs to be changed (Söderblom, 2012). This is why the industry gradually tries to change from the old model and replace it with new financing structure models. The traditional closed end Limited Partnership model has been standard over the last decades.

What has been observed is that new structures and actors such as Crowd financing, Family offices, Angel networks and Evergreen funds are taking place in the industry. The industry is clearly undergoing several changes with an uncertain outcome. Both academics and professionals within the VC industry might find the ongoing changes frustrating and unclear. The problem is that many of these new models and forms are still quite undeveloped, and the results and outcome are still unknown, which makes the future of the industry even more uncertain. This study will look into the different Venture Capital financing structures, providing a broader perspective on the VC industry and its current state.

1.2 Objective and Purpose

The aim of this report is to investigate the different financing structures within the Venture Capital industry. We will weigh the benefits and disadvantages for every financing structure. The purpose of the thesis is to study the VC Industry. The goal is to evaluate the logic why market actor's change from closed end Limited Partnership structure to other new forms, for instance Evergreen fund structure. This study will tackle the uncertainty of the market, explaining the current state of it, and finally find behavioral patterns of the investors when deciding for specific financing models. The results of the study will provide and form a basis for better understanding in what direction the industry is heading.

1.3 Research Questions

Our research questions will give us a deeper understanding and insight of our subject; subsequently analyzing our findings which will give us indication on the future development of the Swedish Venture Capital industry.

- 1. What are the logic and reasons for Swedish Venture Capital companies for changing from the standardized closed end Limited Partnership structure to other financing forms? What are the actual incentives by doing so, and what are the pros and cons with it?*
- 2. What are the motives behind creating syndicated investments in the Swedish Venture Capital industry?*
- 3. What are the current trends that will influence the development of the Swedish Venture Capital industry? How have the VC actors adapted their investments strategies since the aftermath of the Dotcom-crash?*

1.4 Limitation

The topic is general for all firms and actors within the Venture Capital industry, even though our main focus will be concentrated on the two main structures, closed-end Limited Partnership and Evergreen. It is of relevance since the Venture Capital is more or less a prerequisite for early-stage companies to grow further. This paper will also investigate and examine both the current state of the Swedish Venture Capital market and the expected development of the industry. The research is limited to the Swedish market and the different actors within it.

1.5 Background

1.5.1 Definition of the Venture Capital industry

Venture Capitalists are investors within the subset of Private Equity. They raise money from foundations, organizations, rich individuals, pension funds, and other actors that are willing to invest. When the money is raised it is put into a fund with different lifespans that is dependent on exit strategy. These funds are primarily investing in high growth and high risk firms (NVCA 2012). One of the most common structures within the VC industry is called the Limited Partnership (LP) structure, where the investments are eventually sold or dispersed to the investors (NVCA 2012). In LP structures the VC firms are so called general partners (GP), which means that they are fully responsible for the management of the fund, while other institutional (or above mentioned) investors provide the majority of the capital and remain passive in their roles as limited partners. For every service there is of course a price, and as for the LP structures it is the compensation for the fund service received by the GPs. The compensation has two components, where the first one is a monetary compensation paid to the fund managers. Secondly the Venture Capitalists receive private benefits from different activities, such as private benefits that boost their reputation (Gompers and Lerner, 2004).

There is not any clear definition of Venture Capital. The market actors often define Venture Capital as investments in high-tech companies, in their early stage of their life cycles. However, the European definition of Venture Capital can be seen as all different types of Risk Capital investments in companies that are unlisted. Nowadays, the VC investors usually provide their portfolio firms with financial and competence capital, acting as specialists in their investments (Isaksson, 2010).

EVCA (The European Private Equity and Venture Capital Organization) defines Venture Capital as following:

“Professional equity that is co-invested with the entrepreneur to fund an early stage (seed and start-up) or expansion venture. Offsetting the high risk the investor takes is the expectation of higher than average return on the investment. Venture Capital is a subset of Private Equity.”
(EVCA, 2013).

As mentioned before, Venture Capital is a subset of Private Equity, in other words a form of Risk Capital. However not all VC investments are classified as Risk Capital investments. There are two types of subsets to Risk Capital, which are Private Equity and Public Equity. Private Equity is furthermore divided into formal Venture Capital, informal Venture Capital and so called “other Venture Capital”. Most commonly Venture Capital is often referred to formal Venture Capital. The informal part of Venture Capital consists of private investors and Business Angels who are willing to invest their own capital. They typically prefer to invest in earlier stages compared to Formal Venture Capital (Petterson & Öun, 2012).

The major distinction between Private Equity and Formal Venture Capital is that Private Equity generally makes investments in the later stages (for instance buyouts and turnarounds). Private Equity actors are not as active owners as formal Venture Capitalists when it comes to their investments (Isaksson, 2010). The subsets are visualized in Figure 1 (see below).

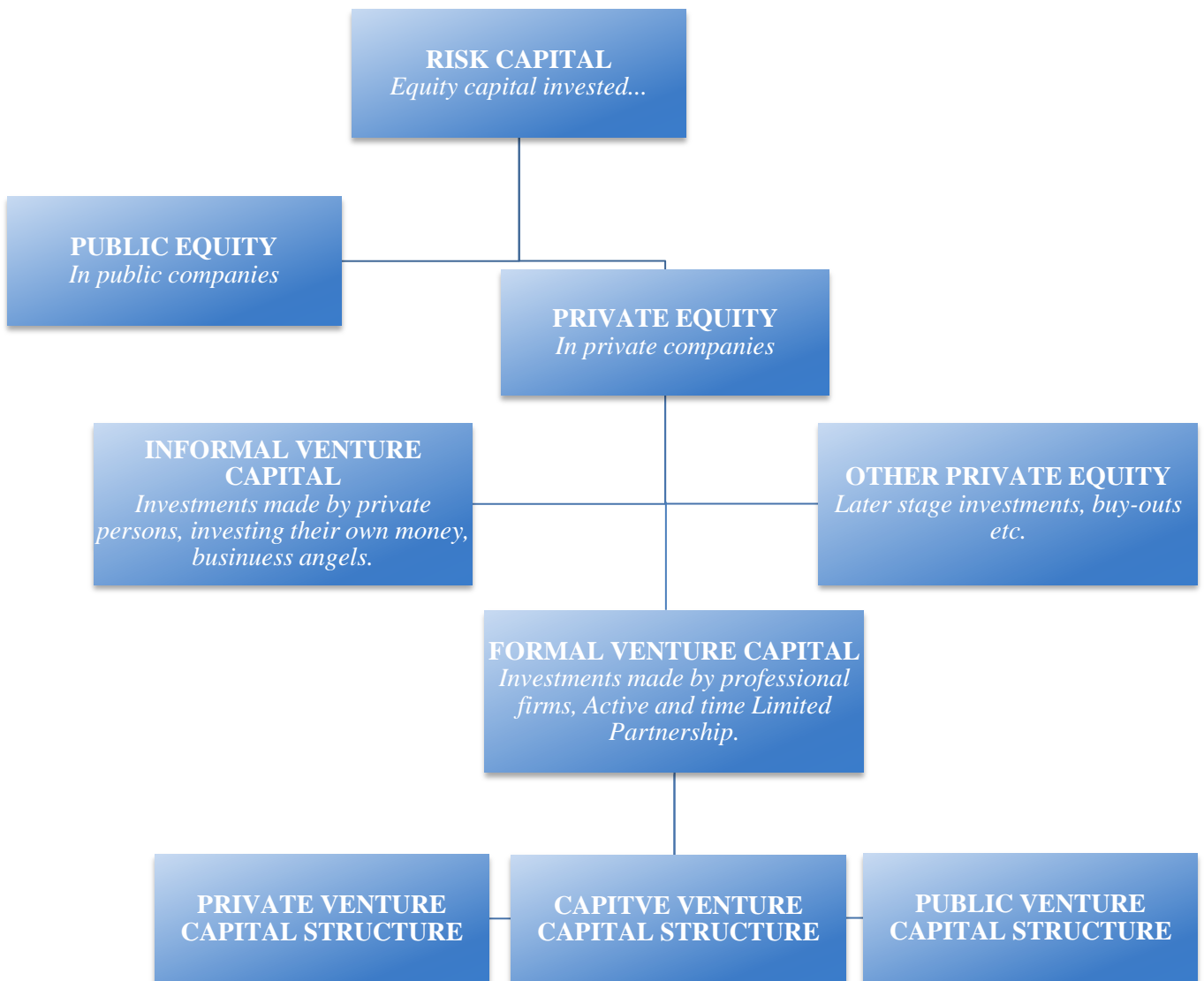


Figure 1. Presentation of the different types of Risk Capital (Petterson & Öun, 2012)

1.5.2 The history and development of the VC industry

When looking back in history, Venture Capital has been very important for the growth of different economies. Venture Capital has historically been one of the reasons for the success of science and innovations within developed economies such as for example the U.S. The U.S is also the country where the VC industry has its roots from, and it all started in the end of the 19th century during the industrial development which was primarily financed by private funds (ESBRI, 2012).

Venture Capital became institutional in year 1946 when the first two VC firms were created, named *J.H Whitney & Company* and *American Research and Development Corporation*. In 1958 the Small Business Investment Act was introduced which made it easier for small businesses within the U.S to get help with financing and management. Some years later during the 1960s the first Private Equity fund was raised, and it is still the same common Limited Partnership form that is used today (Corporate livewire, 2012).

During the 1970s and 1980s three different “leverage buyout” boom cycles occurred within the VC industry (Inside the Firm, 2009). During this era a new legislation came into force called ERISA, which allowed pension funds to invest in VC funds. In the middle of the 1980s there was a huge need for Venture Capital, which was due to the growing biotech industry. Also during the same time the capital gains tax was changed. In the 1980s the stock market developed and released much capital which made it possible for small unlisted businesses to have their shares traded by investors. All these events were very beneficial for the VC industry which expanded vastly during these years (ESBRI, 2012).

At the end of the 1980s the VC industry suffered declining returns, the stock market collapsed and international investors withdrew their capital from the U.S market (Söderblom, 2011). The consequences became devastating for the industry, and in the beginning of the 1990s only the most successful VC firms had survived. Eventually the returns became positive again, and the industry expanded again reaching the next boom in the late 1990s due to the success of the high-tech industry and innovative firms within promising internet technologies. This boom eventually led to the famous Dotcom-crash and the NASDAQ stock exchange crash in March 2000, which led to huge valuation drops for innovation high-tech firms. This basically “paralyzed” the whole VC industry on a global basis. A huge amount of VC firms vanished from the market when investors fled the industry. Now, a decade later, the VC industry has still not recovered from the Dotcom-crash (Söderblom, 2011). See figure 2 for Private Equity fund development data.

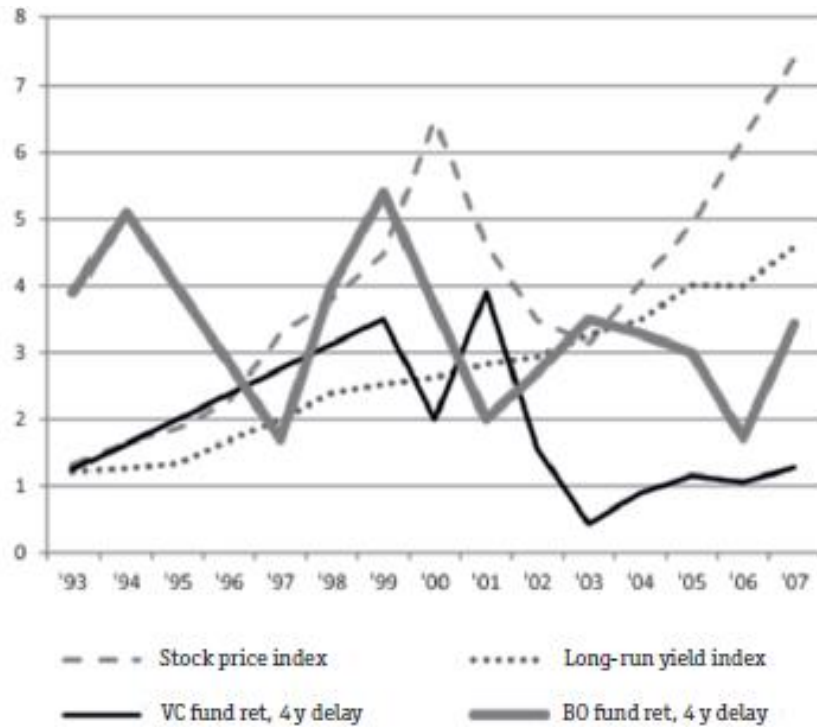


Figure 2. Private Equity fund performance multiples in comparison with stock and bond indices

1.5.3 The current state of Venture Capital

Söderblom (2012) stated that the VC industry in Sweden is in a deep crisis. The average returns are low and fewer investments are made, which has reduced the amount of operational VC firms. Similar patterns are observed in the rest of Europe and in the U.S. There is a growing debate regarding the crisis which focuses on where the industry will go from here. Two opposing views are being presented 1) “this is a natural downturn due to the inherent cyclicality of the industry from which it will recover” or 2) “the VC model is broken and needs to go through fundamental changes”, both quoted from Söderblom (2012). Further quoted from Söderblom (2012) “When more capital has been committed and invested in Venture Capital, vintage year returns suffers”. Earlier research also mention that the VC industry has created a self-correcting mechanism where periods of poor performance has led to decreased inflows of capital, which however would lead to recovery in returns (Kaplan and Lerner, 2010). Other researches argue for the “broken VC model” point of view, and are questioning the way the VC industry function. They argue that the current problems in the industry are not outcomes from the ongoing crisis, but rather reflect more fundamental problems (Kedrosky, 2009). Furthermore they say that the industry needs to undertake radical changes, and for example modernize and improve the setup

and structure of VC funds. This means to include new VC financing models and methods, and a permanent downsizing within the industry. These are changes that will impact the market and result in a rather new and different VC industry (Söderblom, 2012).

Kedrosky (2009) discuss three other interrelated possible reasons for the ongoing changes and problems within the industry. The first reason is that there may be too much allocated capital to Ventures, and the effect of higher valuations and lesser exits multiples. Secondly he explains that it is possible that the exit markets are shrinking, for instance decline in IPOs, which directly prevents VC investors from earning returns in the same extent than previously have been possible. Finally he mentions that the Venture Capital industry has a lack of a functional structure. When the core markets as for example telecommunication and information technology were successful and mature they started delivering lower returns, while new “venture ready markets” did not emerged at all (Kedrosky, 2009).

Gompers and Lerner (2004), highlight the question of sustainability. They mean that the natural growth of the industry during recent years has raised this question. The demand for supply of VC investments has been affected by so called short-run shifts, which has resulted in dramatic consequences. For example, periods with fast increase in investment commitments have led to larger capital inflows to VCs portfolio firms. This has resulted in higher valuations for these investments. The outcome of higher valuations has created less restrictive partnership agreements within the industry. All these patterns have led to the conclusion that the VC industry is cyclical, saying that side effects (which are created by rapid growth), generate difficulties for the industry. This implies that periods of cutbacks are very sure to follow (Gompers and Lerner, 2004).

2. Method

2.1 Choice of method

For this study, we will use both existing theories and models of the various Venture Capital financing structures and perform a qualitative study. The primary data collection will be based on qualitative interviews from highly experienced market professionals. This thesis will primarily conduct case studies on market participants within the industry. This will give us a deeper insight of both existing as well as new and upcoming financing structures and models.

2.1.1 Research Design

The research paper will be based on qualitative studies that analyses and describes both the current VC market and the potential future development of the market in Sweden. The research is based on structured interviews where the respondents hold different positions within the industry. We will investigate the different financing structures and actors in the market. Recent developments and events, such as new regulations, changes in market behavior etcetera will be used as guidance when conducting our studies.

2.2 Data collection

Since a large part of the study will include interviews, a large emphasis will be on the reasoning of the questions, since they will form the basis for the analysis itself. The responses will be compiled and then analyzed from a broader perspective. A potential disadvantage of this methodology may be that the results will be based on interviews where the response may differ depending on how the respondents perceive the questions. The primary source of data collection will come from qualitative interviews. The answers will be concluded and analyzed. The secondary data will be based on publicly available data from different well-renowned sources.

On the next page a table is presented of the people interviewed for the study.

Name of respondent	Company	Position
Falkenvall, Martin	Eterna Invest AB	Partner and investment director
Katzenellenbogen, Daniel	Serendipity Innovations	Chief operating officer (COO)
Nilsson, Peter	Stockholms Affärsänglar	Business Angel/Partner
Rahmn, Jonas	KTHCHALMERSCAPITAL	Chief executive officer (CEO)
Sjögren, Martha	Northzone	Partner
Talborn, Henrik	SVCA	Chief Economist
Åsklint, Cathrine	FundedByMe	Mentor & Project Manager

Table 1. Presentation of interview respondents

2.3 The Credibility of the study

2.3.1 Reliability

The reliability depends on how easy and how often same results will be achieved if the study would be repeated. The study will primarily gather information from interviews, which means that it can lose some of the reliability. As mentioned before the answers might differ depending on interview respondent. This may in turn result in difficulties when deciding for general conclusions on the results. However our secondary data will come from published sources that are available for everyone and therefore increasing the reliability of the study.

2.3.2 Validity

The definition of validity refers to how well measurements, conclusions or concepts are corresponded accurately to the reality. To refer to our method of choice we assume that there will be different perspectives and approaches during our interviews because of biased answers from the market participants. This means that there is a risk of getting cryptic answers because of the sensitivity within the information given to us. Consideration this we will try to formulate questions that will give as much unbiased information as possible.

2.3.3 Replicability

The replicability term refers to the concept that our study can or will be conducted by others and still give the same results. In this case the answers from interviews can of course differ in some sense, depending on how the questions and interviews are structured and performed.

2.3.4 Selection bias

The definition of selection bias refers to an error that occurs when a sampling group is selected more than others. This may lead to an incorrect conclusion if the bias remains unidentified. In our case this may be a problem when conducting the interviews. More precisely we will only conduct interviews with people that have been successful within the industry and hence survived the downfalls of the VC market. We will therefore keep this in mind when concluding our study.

2.4 Division of workload

Since our paper is written by two authors we have to include a division of workload section. Every academic paper of this level should have a descriptive section of which author has written what part. This is difficult in our case since both persons have been active throughout the whole paper and in every section of it. Of course sometimes one person has been more responsible for a section, but has always been backed and checked by the other author. In fact we have together discussed every section of the paper, which always resulted in something being amended. The bottom line is that both authors have been active for every section of the paper, and on an equal level contributed to the completion of the study.

3. Financing structures, theories

3.1 Venture Capital and the company funding chain

The life phase of a company determines of what types of financing source is preferred (Petterson & Öun, 2012). In comparison to other non-Venture Capital funding, the Venture Capital stands for a small amount of the total amount that is invested in companies. As a matter of fact, Venture Capital is not usually preferred as equity or asset class for many start-ups (Isaksson, 2006). A study made by Isaksson (1999), shows that 31 percent of Venture Capital backed companies in Sweden consider Venture Capital funding as the only source to finance their businesses, and this number was significantly higher for companies in earlier stages. The upcoming sections will describe the different phases of a company's life cycle and the preferred sources of funding.

3.1.1 Seed phase

Funding is needed in the seed stage for assets, forming and develop a business concept and for research (EVCA, 2013). According to figure 3 there are relatively low costs in the seed phase and the existing costs are intended to be used for development of the business idea. In this phase the companies create and implement the ownership model. Usually there is high risk rate of failure in this phase, and the equity share for the Venture Capitalist is usually relatively low (Isaksson, 2006).

3.1.2 Start-up phase

In this stage a company needs capital to finance its initial marketing and to develop their product. During the stage companies usually set up a business or put their product into a commercial market (EVCA, 2013). In comparison to the seed phase the costs are significantly increasing due to market research, personal recruitment and the product development. However the business now starts generating some revenues even though this is at a relatively low level (Petterson & Öun, 2012).

3.1.3 Expansion phase

The third and final stage in the company's funding chain is the expansion phase. This is where the companies need funds for further expansions and growth. For instance the companies need

funds for product or market development, hire new additional personal or to increase the capacity of the production. It is in this phase that companies mature, and can be divided into late and early expansion phases. When reaching early expansion the production and sales increase, but without generating any profit. In the later expansion phase, companies usually starts generate some profit, but they are still in need for extra capital. This capital can be used for funding marketing campaigns, product improvements and for further development of the business (Petterson & Öun, 2012).

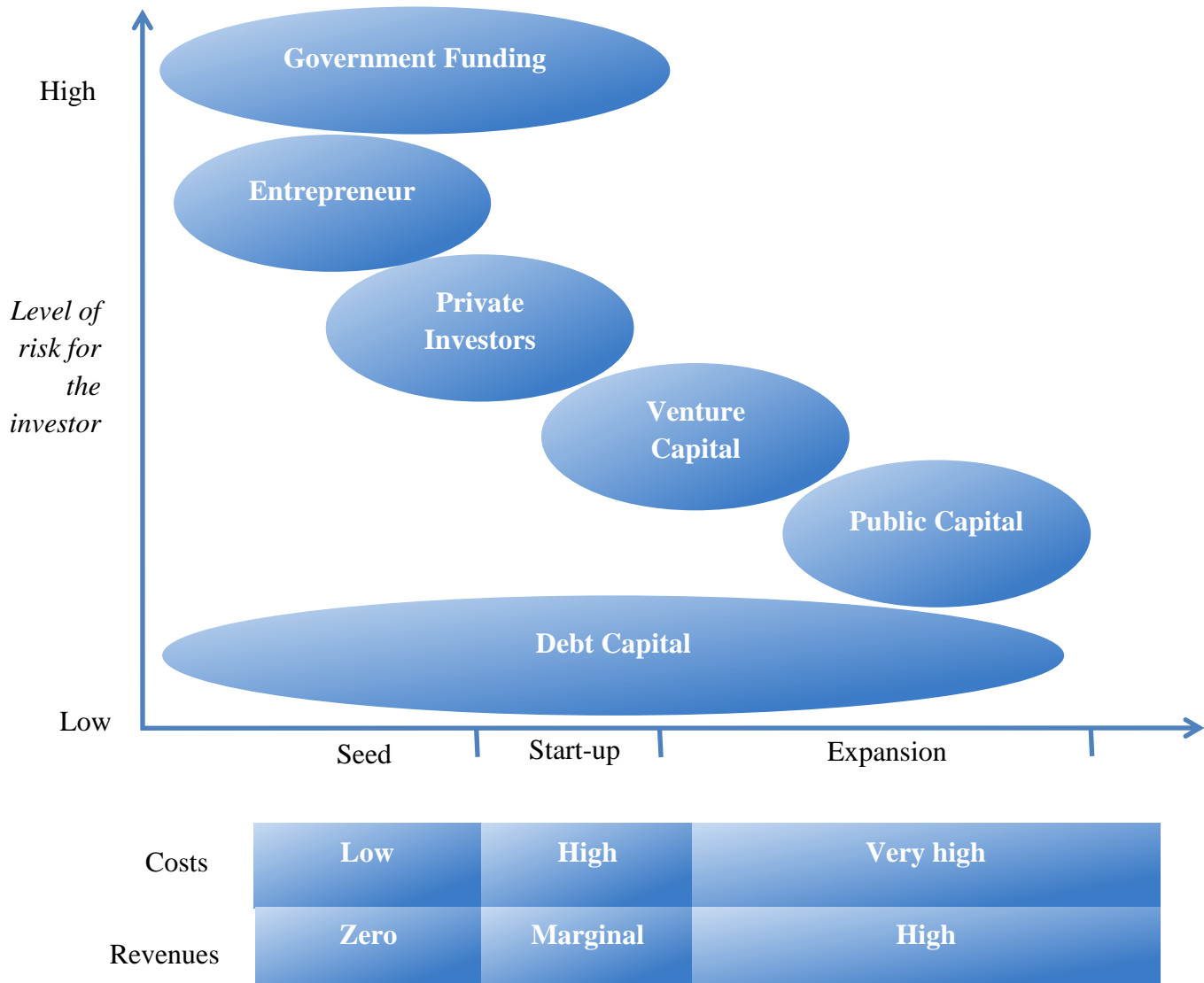


Figure 3. The company funding chain (Isaksson, 2006)

3.2 Investors

There are five groups of investors. The first group is classified as professional investment companies, which include Private Equity “fund of funds” and asset managers (Barnes and Menzies, 2005). The second group includes hybrid companies that use a hybrid investment model, which is a mix of external and internal investment management teams that mainly concentrate on particular investment areas (Harvard Management Company, 2013). These types of companies manage and invest for their parent organizations but also on behalf of external organizations (Barnes and Menzies, 2005). Banks, insurance companies and private pension funds are typical examples of investors that may have hybrid teams within the organization. The third group can be called balance sheet investors, managing capital from their owners. Example of investors may be public pension funds and family/foundations (Söderblom, 2011). The fourth group is non-financial investors and includes corporate investors and government agencies. Their incitement to invest in Private Equity is not only financial motivated, but they also invest for other reasons and factors, such as technology development and stimulating job creation (Söderblom, 2011). The fifth and final group is Business Angels which will be further explained below (see chap 3.2.1).

3.2.1 Business Angels

There are several definitions of the term Business Angel. Lerner (2000) defines a Business Angel as: *“A wealthy individual who invests in entrepreneurial firms. Although angels perform many of the same functions as Venture Capitalists, they invest their own capital rather than that of institutional or other individual investors. (p. 515)”*

Another definition of the term is defined by Mason and Harrison (2008): *“A high net worth individual, acting alone or in a formal or informal syndicate, who invests his or her own money directly in an unquoted business in which there is no family connection and who, after making the investment, generally takes an active involvement in the business, for example, as an advisor or member of the board of directors. (p. 309)”*

Typical characteristics for Business Angels are that they primarily invest in early stage companies (start-ups), usually before the product or services have entered the market. Generally the size of the investment is smaller compared to more corporate investors such as Venture Capital firms. A

typical Swedish Business Angel invests approximately between 250.000 to 500.000 Swedish crowns in one single project, and this amount can be injected gradually. Business Angels are typically looking for “Homeruns”, in other words an investment with a potential to extreme high growth and return. According to Peter Nilsson (2013) the Business Angels are extremely willing to take risk when it comes to choosing investment opportunities. Therefore they expect that some of the investments will most likely fail or be less successful than expected. According to Peter the Business Angels are regional in scope when it comes to new investment opportunities.

A new and up-coming trend is that Business Angels work together and create networks where each individual angel is a partner of the company (the network). This will be further explained in section 3.2.2. (Nilsson, 2013).

3.2.2 Business Angels networks

Usually Business Angels invest through a Business Angel network, in other words the network can be seen as a platform where several Business Angels gather, with the purpose to connect Business Angels with entrepreneurs seeking capital. At the moment there are several Business Angel networks in Sweden, for instance *Sting* (Stockholm Innovation and Growth) and *STOAF* (Stockholms Affärsängelnätverk). These are examples of formal Business Angel networks and this should not be associated with informal groups containing numerous private investors (SVCA, 2013)

3.2.3 Family offices

A family office is known as private wealth management advisory company that serves wealthy investors. The main different between Family offices and the more straightforward wealth management firms is that they offer a total solution to managing services such as budgeting, charitable giving, insurance, wealth transfer, tax services and family-owned businesses. Family offices may thus include non-financial issues. For instance travel arrangements, private schooling and other household arrangements. (Investopedia, 2013).

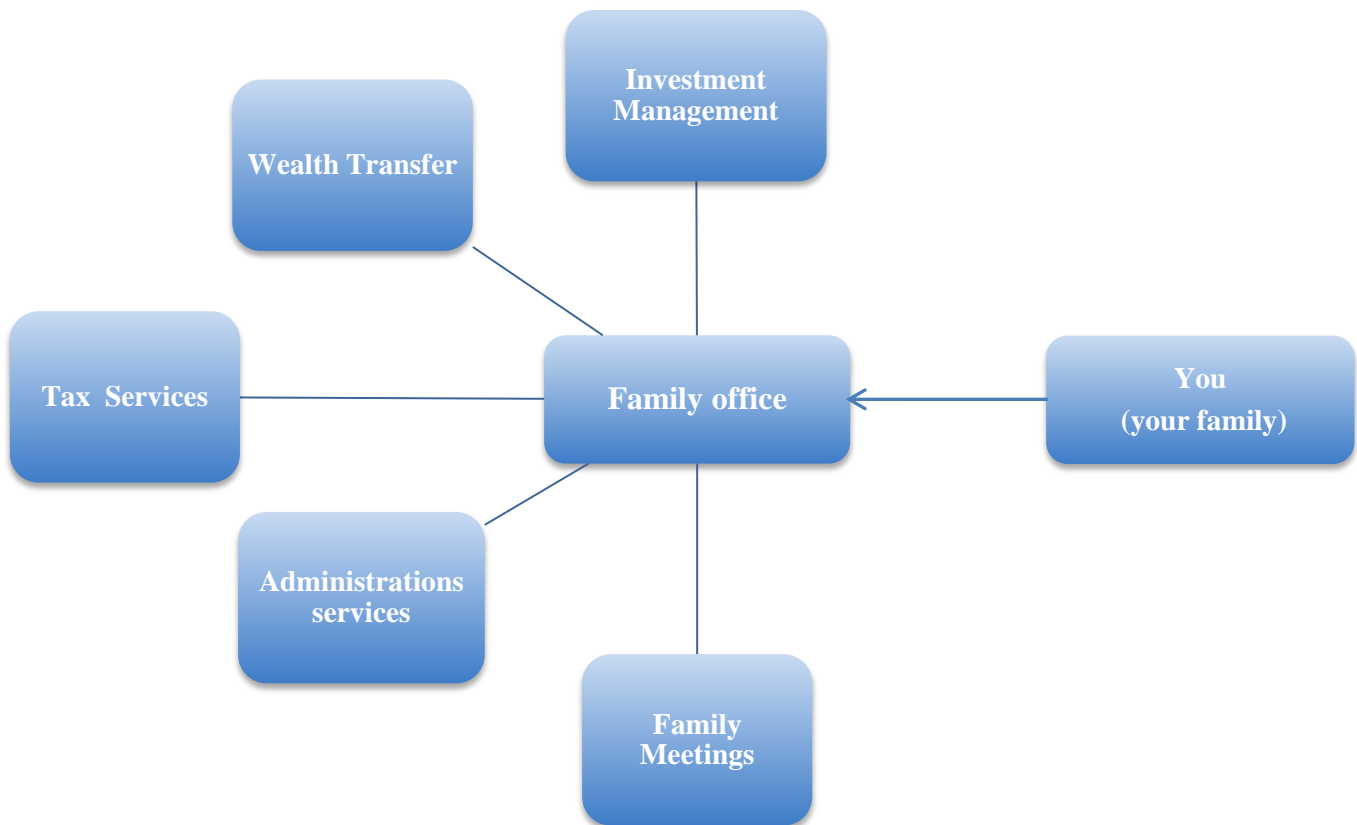


Figure 4. Family office services

There are two kinds of family offices. First there are single family offices which serve one single wealthy family. Single-family office (SFO) is the most common type. The second one is related to the traditional private wealth management practice, which are serving several clients at the same time. This type is known as multi-family offices (MFO) (Investopedia, 2013).

3.3 Investment relationship process

Understanding how to structure a partnership and how to raise a fund is central for understand the Venture Capital cycle. Earlier research suggests that the demand for VC plays the most important role in the fund-raising process. One important factor is the capital gains tax rate, where lower rates will increase the quantity of raised VC. Also macroeconomic factors such as increase in Research and Development (R&D) spending and higher GDP growth can lead to greater activity within the VC industry. When discussing raising capital for the individual fund, it is the earlier performance of the fund that is the most important determinant (Gompers and Lerner, 2004).

The main parties are the investors (also called fund providers) entrepreneurs and Venture Capitalists. Venture Capitalists and investors are the ones representing the supply side, which leaves the entrepreneurs representing the demand curve of Venture Capital. One might see the Venture Capitalists as “brokers”, because they serve as intermediaries between entrepreneurial firms and investors. This means that Venture Capitalists work from two directions where they are a supplier of financial and “non-financial” capital to entrepreneurs and start-ups, while also seeking capital from other investors. The relationships are formal and contractual, but also of reciprocal nature that is built on trust. If the trust is loosed between the parties then the relationship is directly damaged. Therefore it is important to value the relationship with investors almost as much as the relationship with portfolio firms, to avoid possible conflict. The issue of control and ownership between entrepreneurs and Venture Capitalists has often been a barrier that caused problems for the relationship between the parties (Isakson, 2006).

3.3.1 Discovering new deals

Two different approaches exist for Venture Capital companies when it comes to spotting new venture investments opportunities. First there is a proactive approach which means that the Venture Capitalists are active in their search when seeking new entrepreneurial companies with high potential to invest in. For example by direct involvement in innovative and influential environments, or by attending in relevant events for the industry (which can be seen as a platform where entrepreneurs and Venture Capitalists can connect with each other). The second approach refers to a more reactive approach which implies that the Venture Capitalists wait for new business opportunities (Sweeting, 1981). A study conducted by

Engebretsen and Lundberg (2000), shows that the main sources when finding new investment opportunities are informal networks and direct contact with the entrepreneurs. The additional sources for finding new investment were financial intermediaries, formal partners/network and as mention before, the proactive search approach. The conclusion from the study was that the Venture Capitalists were mostly using a reactive and passive approach when processing new deals.

Co-investments or syndicated investments are preferred and commonly used by Venture Capitalists when it comes to funding new investments. This means that the investors likely prefer to include other investors. Some examples for syndicating investments are to access more investment opportunities, create a deeper knowledge when deciding for new investments, and to spread the risk (Isaksson, 2006).

Quoted from McNally (1997), (p.111): *“Co-investments with Venture Capitalists (parallel investments) are a potentially beneficial way of identifying investment opportunities and also accessing the investment expertise of the Venture Capitalist”*. This relationship implies that Venture Capital managers must have a reversible commitment towards each other when it comes to provide other managers with business ideas and opportunities. Once this commitment is fulfilled, managers are able to gain the benefits of accessing business opportunities from other managers (Isaksson, 2006).

3.4 Financing structures

3.4.1 Limited Partnership

As mentioned before, the Limited Partnership structure has traditionally been the most common investment structure for the VC industry in many European countries, including Sweden. It is also a common structure in the U.S. The Private Equity or VC firms serves as general partner (GP), and different investors serve as limited partners (LPs). This partnership is considered to be a very attractive structure and vehicle for the investors due to tax advantages (Sahlman, 1990). One of the most important conditions within this structure is that the LPs are not whatsoever allowed participating in the active management of the fund. This leaves the LPS with less liability, in other words their only commitment is to invest financial capital. The GP however has full responsibility which means unlimited responsibility for the investment activities and the

consequences of investment and management decisions. These partnerships are structured as closed-end funds with a typical lifespan of ten years, and sometimes with a possible extension of two years (Gilligan and Wright, 2010).

The Limited Partnership structure is rather standardized (see Figure 5.), where every fund has a group of investors. For example the LPs, which are mostly institutional investors (but sometimes also wealthy individuals). The investors commit for providing an assured amount of invested capital to the fund during its maturity, and this is called committed capital (Sahlman, 1990). When the fund is established, the GP has some time to identify and make investments, the so called "investment period". This period is normally around five years (Kaplan and Schoar, 2005). When the GP has made the investment decisions it is time for "drawing down" the required capital from the LPs. When time passes, the GP will have created a portfolio of investments. The number of portfolio firms within a portfolio can vary and is depending on which strategy the GP is using, but are mostly between five to twenty firms in each portfolio. The remaining time of the fund's maturity will be used by the GP to manage the portfolio and eventually exit the included firms within it. The GP will finally liquidate the portfolio and divide the profits between the GP and the LPs. In order to stay in business the GP has to raise a new fund at the end of the maturity of the current investment portfolio (Söderblom 2011).

The payment structure between the GP and LPs is quite standardized. The compensation given to the GP is consisting of both variable and fixed components. First there is a management fee that the GP earns, which should cover the operating costs from the active fund management. The fee is usually set as a percentage of the total committed capital within the fund. The fee is fixed and not dependent on the performance of the fund, and is usually one to three percent. Return from the disposed investments will first be used to cover LPs invested capital plus a hurdle rate, or so called preferred return. When that level of return is achieved the GP is also able to share the profit, which means that there are of course some goals to exceed for the GP, before even profiting anything at all from the returns. Typically the hurdle rate is somewhere around 8 to 10 percent of the total invested capital. The GP will share the excess once the investors have received their pre-agreed rate. Lastly the GP gets a "carried interest" based on the funds success, and is mostly standardized at twenty percent of the profits (Söderblom 2011).

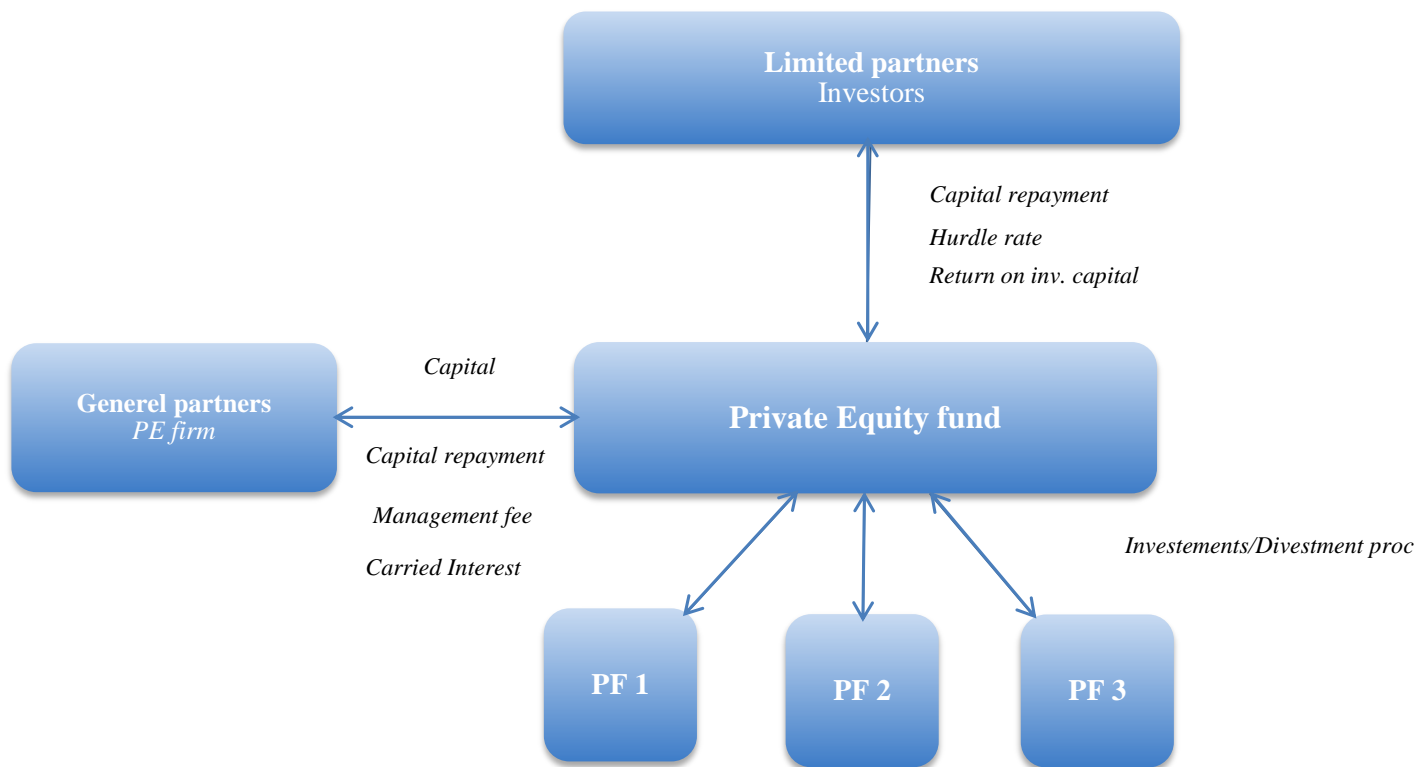


Figure 5. Limited Partnership structure

3.4.2 Evergreen funds

As mentioned in the background section, some scholar and professionals say that the traditional VC model is broken. One way to tackle this has generally been to move from Closed-End Limited Partnerships to Open-End Private Equity vehicles, also known as Evergreen funds (Institutional Investor, 2012). Unlike the traditional closed-end structure, Evergreen funds do not have a fixed maturity, which mean they can have an infinite life time. They do not have any obligations to liquidate their investments, and can also reinvest realized returns into new investments (Phalippou and Zollo, 2005).

The Evergreen structure has three key advantages over the traditional model. An Evergreen fund invests regularly during a long time period, instead of only investing the first five years and terminating the investments after 10 to12 years, compared to the traditional LP structure. A long and “endless” time horizon gives the Evergreen fund opportunity to foster investment decisions that are based on profitability with longer term growth instead of only “quick flips” (Business Journal, 2008). The nature and structure of an Evergreen fund reduces the temptation and need

to heavily invest in new portfolio firms during times of market exuberance. Another advantage is that Evergreen fund managers are relieved from distractions and conflicts due to periodic fund raising. As mentioned before the traditional structures forces fund managers to raise new funds to stay in business. A third advantage is that there are more ways of getting back the return on committed capital from an Evergreen fund. Apart from traditional methods as sale or Initial Public Offering (IPO), it is also possible to pay out dividends to the fund investors. This means that it is not necessary with a strong Merger and Acquisition (M&A) or IPO market for an Evergreen fund, making it safer for the investors (Business Journal, 2008).

The general criticism for an Evergreen fund is illiquidity. The criticisms come from the concern of how investors are supposed to get back return on committed capital when the realized returns from the fund are continuously being reinvested. The solution has been an option for investors to receive dividends, or getting a portion of any realized returns from the fund (Business Journal, 2008).

3.4.3 Crowd Funding

New firms have usually problems to attract external capital through bank loans or to get equity capital (Berger, A. Udell, G. 1995). An opportunity for the entrepreneur to attract capital is through Crowd Funding. Crowd Funding is a new and innovative financing structure, which has become popular in recent years. The basic idea of Crowd Funding is to use a large crowd to obtain feedback, solutions and ideas to get corporate activities (Howe, 2008; Kleemann et al.,2008).

More precisely, Crowd Funding describes a web-based business model where different creative solutions are highlighted for a crowd. Mark Robinson and Jeff Howe came up with following description: (2006) “the term crowdsourcing describes a new web-based business model that harnesses the creative solutions of a distributed network of individuals through what amounts to an open call for proposals”. As mentioned Crowd Funding is not just about raise capital but it is also a way to evaluate the product at an early stage and see if the future audience will buy the product or services (Internetworld, 2013).

Through different social platforms (suchs as Twitter, Facebook, LinkedIn, Blogs) the entrepreneur can attract money from a large audience. The amount of money the entrepreneur can raise from one single person is relatively low compared to what other VC structures can generate per

investor. The major difference between these structures compared to other financing methods is that the entrepreneur obtains the capital from a larger audience which in the end may result in a significant amount of money (Belleflamme P, Lambert T, Schwienbacher A. 2012).

3.5 The criteria of Venture Capital investments

There are four types of criteria that Venture Capitalists evaluate when deciding for different investment decisions. The following steps are 1) Evaluation of investment 2) Valuation of the firm 3) Contracting 4) Financial structure.

3.5.1 Evaluation of investment

A number of studies have shown that Venture Capitalists reject the majority of the incoming proposals in the screening phase (Mason and Harrison, 1999). In the evaluation step there is a time-consuming due diligence process which can be seen as an important process in the evaluation phase. There are several known problems when it comes to selecting new venture firms. First there are difficulties in estimating the potential the entrepreneurial firms have. Secondly there are difficulties in estimating the risk of failure.

Many projects may also be in an early stage which implies that there may only be a sketched out business plan and some intellectual rights of the service or product. Furthermore there might be a lack of information about the market. For most of the projects there is a high level of risk when it comes to uncertainty of success. Again the information asymmetry is an often-stated problem in this phase (Isaksson, 2006). To minimize this problem investors use several different methods. For instance some of these methods are environmental selection (Volberda and Lewin, 2003), reliance on self-selection by the entrepreneur (Gompers and Lerner, 1999), syndication of investment decisions (Sorenson and Stuart, 2001), use of selection criteria and checklists (MacMillan, 1985) and social networks for knowledge transfer (Venkataramanan, 1997).

3.5.2 Valuation of the firm

The traditional valuation process can be derived into the following steps (Damodaran, 2002):

- Evaluate the potential profitability and revenue.
- Make a forecast of the future value.

- Target an ownership position in the firm.
- Negotiating the valuation of the firm

There are many differences between valuing a public firm and a private firm. First of all public firms operate in a more regulated environment (for instance when it comes to accepted accounting standards) compared to private firms. It is easier to find information of the public firms since they are under a legal obligation to provide some information in public. This information is harder to get access to when it comes to the private firms. Third, there is no track record and current prices for equity to obtain in private firms compared to the public firms. Fourth, the costs to liquidating an equity position in a public firm are much lower and the task is easier in a public firm than in a private firm. This is mainly due to the absence of the marketplace.

Finally there are problems for the owners in a private firm to separate or differentiate between business expenses, dividends, management salary and personal expenses which of course will affect the cash flows, expected growth rates, discount rate, and hence the valuation (Isaksson, 2006). Isaksson (2006) presented the following most common valuation techniques (in descending order from most common to least common method). The methods are examined from 52 investigated issues concerned the valuation of Venture Capitalist's investment in the Great Britain, France, Holland, Belgium and United States.

Order	Valuation method
1	Capitalized maintainable earnings (P/E multiple – prospective basis)
2	Capitalized maintainable earnings (EBIT multiple)
3	Recent transaction prices for acquisition in the sector
4	Discounted value of free cash flows
5	Capitalized maintainable earnings (P/E multiple – historic basis)
6	Pay back period
7	Industry’s special rule of thumb pricing ratio (e.g. turnover ratios)
8	Discounted future cash flows
9	Responses to attempts to solicit bids for the potential investee
10	Historic cost book value
11	Liquidation value of assets (orderly sale)
12	Dividend yield basis
13	Liquidation value of assets (forced sale)
14	Recent PE ratio of the parent company’s shares
15	Replacement cost assets value

Table 2. Valuation methods

3.5.3 Contracting

The role of Venture Capitalists in the capital market is quite unique. They are external investors that have to evaluate risky projects, control for all undertaken risk, and add value to their portfolio firms. Once the entrepreneur and the Venture Capitalists start negotiations on an investment proposal, it creates the opportunity for scrutiny. Earlier experience has indicated that due to different expectations of the future role within the relationship by each party, the risk of conflict is high. The roles are later on subjects for contracts, and hence the importance of forming an initial favorable contract for each party, which creates the basis for a successful relationship and co-operation (Barney et al, 1994). This justifies and explains the time that VC firms spent on contract writing and negotiation in the VC investment process.

The negotiation process which leads to a contract is intended to increase the relationship and create a better understanding between the Venture Capitalists and entrepreneur. After the process is done and the deal is made a greater transparency occurs between both actors, of mutual expectations. Negotiations of such type may be of great importance, surfacing principles

and values that are required for building and maintaining a relationship. It is also believed that the negotiation period allows both parties building a long lasting relationship (Isaksson, 2006). Landström et al (1998) mentions that contracts covenants are very much used to avoid problems that may affect the relationship, such as different agency problems, reducing the risk of moral hazard, and for protecting the investors against entrepreneurs with intended adverse actions. It is also suggested that the contract negotiation period may be used to improve common goals, and also to reduce the information gap and information asymmetry between the parties (Isaksson, 2006). Therefore, the contract negotiation process may be seen as more of a common process for the parties to identify and tackle obstacles such as for example agency problems that may be a potential threat for the relationship (Isaksson, 2006).

3.5.4 Financial structure

The main core of Venture Capital investments is that the capital and competence is transferred from the Venture Capitalist and the entrepreneur (portfolio firm). The competence is transferred in a so called “value adding phase”, and the capital is transferred in the final end phase of the investment decision. However the capital is not transferred all at once, but through stages. This structure gives the Venture Capitalists more control over operations and management of their portfolio investments (Isaksson 2006).

Isaksson (2000) made a survey on the deal structure between entrepreneurs and Venture Capitalists in Sweden. The survey showed that six financial instruments are commonly used for deal structures of such type. We have illustrated the results earlier in Figure 6.

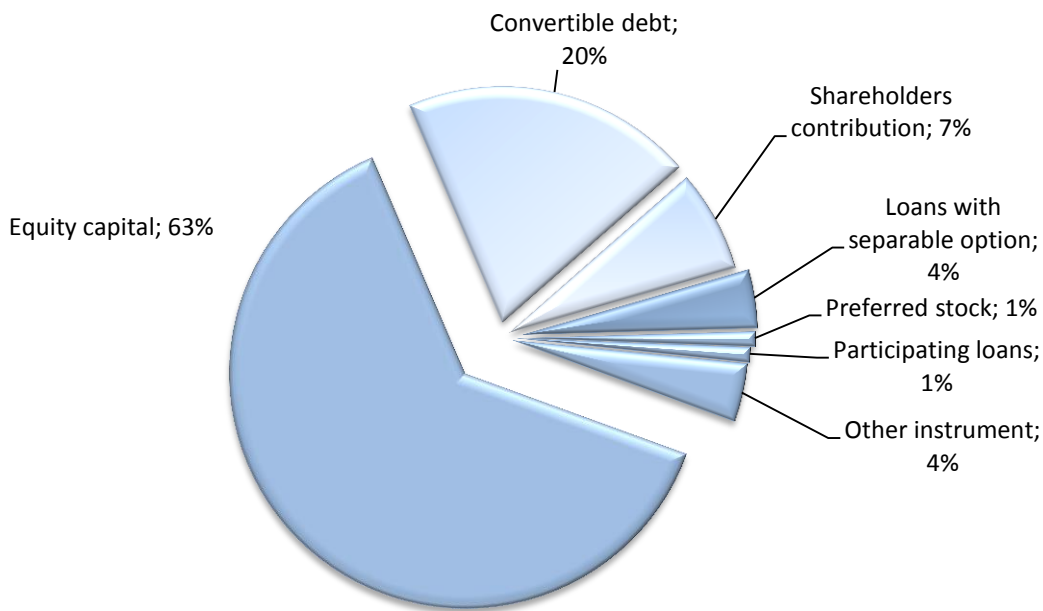


Figure 6. Commonly used financial instruments among Swedish Venture Capitalists, usage shown in %

Using equity for an investment gives the investor a stake in the portfolio firm but also a risk by making the returns very much rely on future dividends, and capital gains when the firm is sold. The equity investor becomes a visible investor and owner (Isaksson 2006). The portfolio firm's solvency is strengthened due to the amount of equity that the investor brings to the firm. Another deal structure called preferred stock separates itself from "standardized pure" equity by adding additional preferences or privileges. One example of a privilege can for example be that the holders of preferred shares have preferential dividend rights if bankruptcy would occur, or simply that they have better terms for their dividends than other equity shareholders. Therefore some argue that preferred stock is less risky than equity capital (Isaksson 2006). Norton and Tenebaum (1992) mean that preferred stock is the most commonly used financial instrument for U.S Venture Capital firms. As shown in figure 6 above, Sweden differs from the U.S on that part, where Swedish VC firms prefer to use equity capital.

3.6 Information asymmetry

One overall risk for Venture Capital firms lies within the uncertainty of the entrepreneur's competence and ability to succeed and achieve common goals. This risk will always remain, no matter how thorough the due diligence has been performed. This risk can be seen as information gap between the entrepreneur and the VC Company, and often arise due to information asymmetry. VC companies tend to look for investments within industries and segments where monitoring costs and asymmetries are less severe. The situation can be compared to when Banks are to approve loan credits, where one party has far more information than the other party (Rask, 2009).

However VC companies have some advantages compared to the Banks and other financial institutions. VC companies usually have access to more in-depth financial information, such as non-public information that can be used as competitive advantage against other actors within the industry (Yung, 2009). The problem around the information asymmetry can be illustrated with help of the "lemon-principle" by Åkerlöf (1970). The gist of the example is the emergence of information asymmetry. In the end investors cannot separate a successful investment from an unsuccessful. The consequence of this problem is that good investments are omitted and bad ones are being made. This example demonstrates a similar effect on the capital market, where the investors find it difficult to distinguish between investments. Both the capital market in general and its function in society will be harmed as long as the information asymmetry remains. According to this information problem, VC companies have developed methods and approaches to reducing the information gap. However the problem is a considerable part of the difficulty of VC companies. If half of the business ideas from the entrepreneurs are classified as "good" and the other half are classified as "bad", the following two distributions can be made: i) in case of when VC companies cannot distinguish between the bad ideas and the good ideas then the bad ideas will be resembled like the good ones. ii) VC companies will include some bad ideas in its portfolio and the mean value of the investment portfolio will imply that some ideas will be overvalued, while some will be undervalued. The majority of the VC investments are conducted in an early phase, when the company information is inadequate. Several studies show that VC companies are particularly good at reducing the information asymmetry problem. VC

investments are often made in high-tech companies that require VC investment in order to develop rapidly, indicating that these companies will benefit from being open in terms of corporate information. Information asymmetry increases when the number of portfolio firms increases. VC companies have an investment strategy that focuses on a wide range of industries and companies, which imply that the VC company will be exposed for a higher degree of information asymmetry. VC companies that focus on a smaller area of investment, such as Cleantech, has a lower degree of information asymmetry compared to VC companies that use another investment strategy (Rask, 2009).

3.6.1 Adverse Selection

Information asymmetry refers to two approaches. The first information problem is known as adverse selection. Adverse selections refer to the situation where the principal hires the agent, but is uncertain about the quality level of the entrepreneur. The uncertainty may be due to the sustainability of the business idea, the expertise level of the entrepreneur etc. Adverse selection includes lack of information when it comes to separate good investments from the less good investments. According to studies, an obvious factor that has increased the information gap is related to the situation when the entrepreneur has acted as if his or her skills have been higher than they actually are (Eisenhardt, 1989).

3.6.2 Moral hazard

The second orientation, moral hazard occurs when the winding agent is not working to the extent that the principal and the agent agreed upon. The basis of the problem of moral hazard arises because of the difficulties of monitoring the agent. To constantly monitor a person is difficult, if not impossible, but with the right skills and approach it is possible to get as close as possible. This comes of course with an increase in costs thereafter. Without monitoring the agent, the opportunity arises for the agent to act in their own interest and report to the principal only about such of the benefit of the agent himself (Rask, 2009).

When applying the moral hazard situation between VC companies and their portfolio firms it can be referred to the time after the entrepreneur has received the risk capital funding. The problem occurs here if the entrepreneur will ultimately only maximize his or her own benefits in the company without releasing any information that would not benefit the person himself, and the

moral hazard is a fact. Moral hazard is of the nature ex ante, which means that the phenomenon occurs after the entrepreneur has received the capital (Rask, 2009).

4. Empirical Study

4.1 Interview Results

The following section is based on interviews from different market professionals. The respondents have been chosen carefully so that they possess enough relevant knowledge and experience within our field of study. We have interviewed professionals of Venture Capital firms, innovation management firms, as well as a Crowd Funding professional and a Business Angel representative from an Angel network.

4.1.1 Market overview

The Swedish Venture Capital Association has a Private Equity Managers Index (PEMI) which serves as an indicator on the current economic climate. Currently the SVCA PEMI has a value of 41, which is under the benchmark value of 50 and therefore indicating that the Venture Capital firms altogether are negative in their market assumption and their view on and situation of the industry. This negative view has been observed since the euro crises occurred during the first half of the year 2011. Market professionals state that the VC industry is in established and mean that there is room for more actors in the industry, without causing any damage to already existing actors. Instead there is a great reason to believe that more actors would actually be for the better sake of the market, and eventually make it healthier and better working, resulting in positive effects on existing actors.

4.1.2 Investments and strategies

Since VC market actors work in different ways they also have different preferences and strategies to achieve their goals. We have looked at how Swedish Business Angels work in practice. When it comes to our respondents they work in networks in groups of around 10 to 20 partners. However strategies and number of active angels might differ between networks. Our respondents act as a group in the early stage market in companies where the product has not yet reached the market. Their investment model also allows the partners to invest beside the group in individual investments. They typically invest in the Information and Communication Technology (ICT) market where they search for "homeruns" which means, investments that can give extremely good returns.

According to our Business Angels respondents they expect that 3 to 4 of 11 investments fails. They are rather regional in scope when it comes to investment areas. Looking at the Swedish market, the greater Stockholm region is a dominant area for finding new investments, seen from a Business Angel's perspective. The typical investment for our respondent is in monetary terms between 250.000 and 500.000 Swedish Crones, and is injected gradually until reaching the maximum amount which is 1.5 million Swedish Crones. Sometimes it may happen that co-financers support the angels' investments. The target is to reach exit within 10 years.

When looking at more formal VC firms using closed-end Limited Partnership structures we found that there are some differences in strategies and investments between our respondents despite they use the same structure. For instance one respondent use a semi-captive structure. The majority of the respondents within this category use a 10 year life cycle on their funds, which sometimes can be extended one year. Each of the respondents' funds uses investment horizons somewhere between 2 to 7 years. They typically invest in high-tech firms with an existing product that has been tested in the market. The main policy is to stick to the strategy for every respondent. The number of investors for each fund differs between the respondents. For one respondent there are several foreign investors whereas another has only a few domestic investors. This reflects the size of the fund, where the one with foreign investors is managing over 1.5 billion Swedish crones (which also is the largest VC-fund in the Nordic countries) compared to the other one that only manage around 350 million Swedish crones. The average investment for both respondents is 20-25 million Swedish crones, which is injected gradually during the life-cycle of the fund. The typical investor for this structure is an institutional investor.

We have interviewed actors within the VC-market using an Evergreen fund structure. There are some differences compared to Limited Partnership. For instance the industries they invest in are different in the sense that they do not only invest in High-tech firms, but also for example in special-pharmaceuticals, healthcare, niche high-tech companies that requires special competence, ICT, and also patents for various industries. Another main difference is the investment horizon which for Evergreen funds is eternal. The focus is not on exits but is instead to generate a yearly return of around 20 percent on equity for every invested company. This can be compared to the end of the 1990s where the VC-companies strived to have 40 percent yearly returns. However nowadays it is sometimes required to make exits for extraordinary reasons. The average investment for one of the respondent has a spread between 20 – 100 million

Swedish crowns, which can be seen very high. The sizes of the funds for our respondents are approximately 300 million Swedish crowns. The investment stage varies between the respondents; where one invests in well-established companies with already existing and tested products or services and another respondent develops and finally incorporates ideas. The same respondent does not have any management fee, and there are around 80 investors in this fund. The typical investor for an Evergreen fund is a family office or a private wealthy individual. Despite that the investment horizon is eternal there might still be ways for investors to exit the fund and end the agreements. This can be done with help of a “redemption model” that actually is used by one of our respondents.

4.1.3 The development of the industry

When comparing today's market with the market before the Dotcom-crash, there were significantly more active firms within the Swedish VC-industry. Quoting one respondent the VC-market was “steroid-injected” with financing capital. This means that the market upturn did not follow the real development of the economy. The numbers of VC-firms have also shrunk from between 100-200 to only 5-10 larger VC-firms, and all the small investors are entirely eliminated. This was also something that every respondent pointed out in our interview with them. Also the overall experience level for the investors within the VC-market was quite low compared to the actors that are active in today's market. One respondent means that the view and the attitude has also changed from before, meaning that many actors saw the investments more as gambling opportunities. In other words they saw the VC-market more as a place for trading and gambling rather than searching for pure investment opportunities. Quoting one of the respondents the person explained the uncertainty for every deal processes, “where actors could close deals by just writing down the contract agreements on a napkin (this made it easier to get funding)”. This means that processes that are important today were excluded, for instance due diligence. One of our respondents says that the contract structures have improved and are better than before. This respondent also claims that the Dotcom-crash filtered the market from actors who used a short-term and for today's standards an incorrect investment model. Despite the filtering in the market the respondents have a widespread view regarding whether or not the mentality and mindset has changed as a result of these events. Some of the respondents mean that the mindset has not changed at all, while other respondents mean it has changed a lot and the way the

industry works. They say that the Swedish VC-market has improved and become more mature with more experienced and professional actors, where the U.S has been a source of inspiration.

According to SVCA the investors are more risk averse today, in other words there are less risky investments today within the VC-industry. They also say that this can be connected to the required return, which was around 40% before the Dotcom-crash but has nowadays decreased to around the half. Before the millennium shift actors were much more eager, without realizing that technology was not always adapted to the specific innovation. According to SVCA the technological development is today before what one actually believe it is. For example, it is the technology that creates the demand for using different products rather than people demanding them (for instance surf tablets).

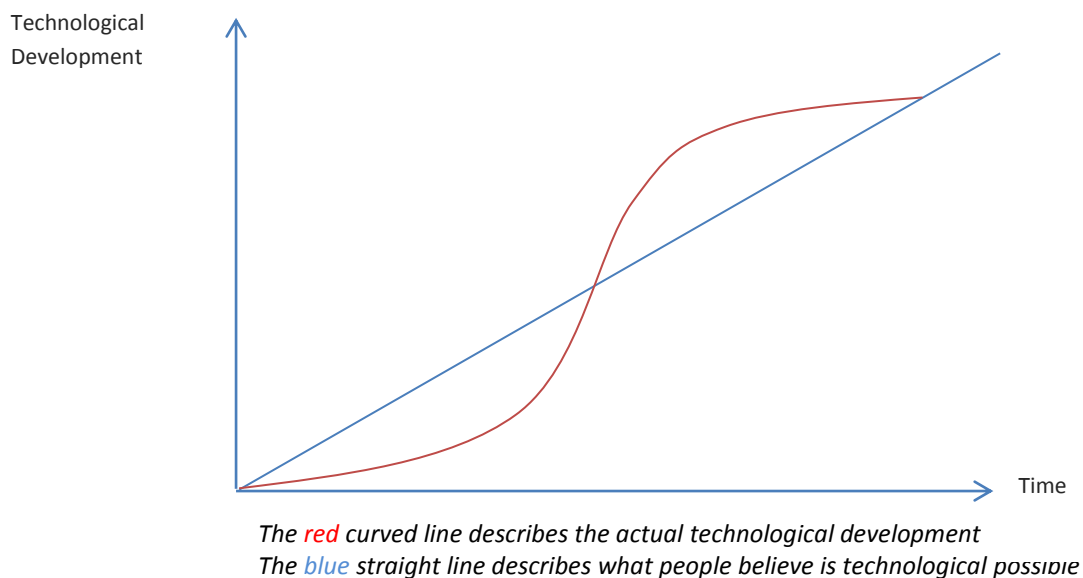


Figure 7. Technological development over time

According to one respondent, for every industry crashes come and go. As for the Swedish VC-industry it has been observed that every tenth year there is a “cleansing” in the market, and every fifth year a minor crash hits the market. Since the Dotcom-crash minor crashes have occurred where some have been of greater importance than others. A major fund that we interviewed indicated that somewhere between the end of year 2007 and the beginning of year 2008 a new filtration came across which wiped the Clean-Tech industry investments and other

capital intensive industries. As a result of this filtration the investment strategies changed, and also the preferred industries to invest in changed.

Market trends

Within the next five years some market trends are expected. For instance Business Angels will undergo some changes. As it has become more difficult for Business Angels to make individual investments, networking will become more important. A network serves as a pool of knowledge and capital, where business Angels share their ideas and contacts. Nonetheless the network also provides safety for the partners. One respondent believes that when the networks become larger the Business Angels will start invest in companies that are beyond the classification of early stage market and instead invest in companies that already have established products. This can be compared to more formal Venture Capital. The overall conclusion is that Business Angels will have greater influence within the VC industry.

One respondent point out that new financing structure will reach the market. This can already be seen in form of Crowd Funding, which usually helps early stage companies raise capital funding. Our respondent believes that this new form might “frighten” the VC investors because Crowd Funding spreads the ownership dramatically. Therefore it can become hard for entrepreneurs to seek additional capital through VC firms.

As a conclusion from our respondents, the VC industry has underperformed for the last couple of years, and has to undergo some fundamental changes. The actors have to customize and adapt the required rate of return and strategy to more realistic goals that reflects the actual economy.

Legal aspects

According to all of the respondents the VC market has been characterized by legal obstacles which have created several great problems. However we have not looked further into the specifics and characteristics of every legal obstacle. This is because we did not have enough time to evaluate and completely understand the impact of every each legal obstacle for the industry.

Employees of VC companies need decent incentives to choose to work there. One respondent says that their salary has to be worth the risk associated with the industry. Currently there is not any effective option-system that would attract people to start work in the Swedish VC-market.

However this does not imply that people does not want to work in the VC-industry at all, but rather that the option-system is a clear drawback for the Swedish VC-industry. According to the same respondent there are currently two different types of options connecting to this problem in Sweden:

- 1) Employee-option: This is a call-option where the holder pays 56 percent tax on the difference between the strike-price of the option and the current value of the company underlying to the option. Beside this there is an additional general payroll tax equal to 31 percent. There is also a risk that the shares will drop which means that the employees would lose money without being able to set off losses against taxes.
- 2) Subscription rights: Subscription rights are “options” that give the holder the right to shares in the future. This option type gives the holder the right to subscribe shares in a new share issue, in other words subscribe for new shares in the company, to certain predetermined conditions. These subscription rights have often at a relatively long holding period, hence the name “warrant”. Subscription rights are to be market valued and paid directly. The different here compared to employee-option is that the holder pays a capital gains tax of 25 percent, when the shares are sold eventually. According to one of our respondents the problem is that the subscription rights requires an initial investment. This also requires that there is money to invest in an early stage, which the employees in the Swedish VC-market do not usually have.

According to our respondent this option problem could be solved by introducing subscription rights without any required initial investment. This is something that is supported by other respondents which also says that the legal aspects of the option system are unfavorable for the VC-industry. However there are some positive legal trends happening currently in the market. It has recently been discussed to introduce an investment deduction. This means that individuals who invest in businesses may able to deduct half of the investment in their income declaration. The investment deduction is estimated to around 800 million Swedish crones. However this will not be introduced before September 1th 2013 since the proposal must be approved by the European Commission (Regeringen, 2012).

4.1.4 Investment criteria

There may be several motives for an entrepreneur to reach out to different Risk Capital actors. The main motive is of course capital funding, but other motives such as “knowledge capital”, help with management and to find board members, getting marketing help, and accessibility to business networks.

By looking at our respondents they have different investment criteria. One of our respondents mentioned that they value market potential and competitive advantage, uniqueness (technical level), strong management team, and financial risk. The respondent mentioned also that it is a great advantage to be first out in the market with a specific product or service. For another respondent they strongly value that the product or service is internationally scalable, and that the product or service is somehow revolutionary.

For our crowd-funding respondent they have no actual criteria on the product or service. The main focus is instead to market and find a “crowd” of people that are willing to invest in a specific service or product.

Something that our respondents have in common is that they all are active in their investments. All respondents have regular meetings and follow-ups either by mail or physical meetings. The majority of our respondents strive to have board minority somewhere around 20 to 30 percent. The levels of activity within the investments differ for our respondents, depending on type of industry they invest in. The Business Angel network that we interviewed has no requirement for a board position. It sometimes occurs that they back up other corporate institutional and governmental investors that have board positions.

4.1.5 Risk aversion

All of our respondents generally have a high risk profile when it comes to evaluating potential investments. Business Angels have an extremely high risk profile since they invest in an early stage, in other words they are the direct opposite to a risk-averse investor. They estimate that 3 to 4 investments of total 11 investments will be unsuccessful. Another of our respondents has changed their risk-profile due to changes in their structure and investment model. This respondent changed from a traditional closed end Limited Partnership model to an Evergreen fund structure. This means that they are more risk averse with the new model compared to the previous one, which in turn has resulted in a lower required rate of return. Our respondent

means that actors who use an Evergreen structure are more risk-averse compared to traditional VC companies that use a closed-end Limited Partnership structure.

When it comes to the Crowd Funding structure it has a risk profile which can be seen as extremely high from the investors' point of view. This is because there isn't any due diligence process, in other word the product or service is tested directly on the market. For our respondent they couldn't give us any information about any exit since they are relatively new on the market (just as the Crowd Funding structure), and therefore no exit has yet been made.

4.1.6 The logic behind using different investment structures

Different investment structures are suitable for different types of investors. Mentioned by a closed-end fund respondent they argue that there might be some pros with an Evergreen structure. There is a safety using that structure due to the fact that the fund can raise capital without any time pressure. However they argue for the difficulties to get actual investors that want to invest in the fund, since it is a structure that normally is difficult to sell in and attract investors with. The respondent mention some negative things about their structure (closed-end Limited Partnership), for instance their experience is that the time limited (exit horizon) of 10 years is normally too short. Some companies require more than 10 years of development before they actually will generate a significant profit. They also mentioned that the Limited Partnership model is relatively hard to manage. Another potential obstacle is when there is a market crash there might be some problems to raise capital for new funds. This is because the investors are conservative during bad periods when the market underperforms.

The Swedish Venture Capital Association (interview respondent) highlighted that Venture Capital companies normally require a high amount of capital for product development in their portfolio investments. As mentioned in the previous section (legal aspects) there is not any effective option-system for the VC-industry. This means that there is a risk for missing a potential option value using a closed-end Limited Partnership structure, as the portfolio companies may not generate profit during the first 10 years. In other words the option would be valued on non-profitable investments, hence missing the potential upside after the exit in year 10. This problem does not occur in an Evergreen structure where the time horizon is eternal. The respondents' conclusion is that the rational economic motive to change from a closed end Limited Partnership structure to an Evergreen fund structure is the omitted option value.

We have interviewed an actor that has recently changed from using a closed end Limited Partnership structure to an Evergreen structure. They mentioned several incentives for this change in structure. They are skeptical to a closed end Limited Partnership structure which they quoted “we don’t appreciate short models where you buy and sell in short cycles (flipping companies)”. They don’t appreciate this model since it doesn’t reflect the real economic development but instead follow only the stock exchange index. They consider that it is better to keep the companies that perform well since there are few of them. This is supported in section 4.1.4 (risk aversion) where one respondent estimate that 3 to 4 investments of total 11 investments will be unsuccessful. Despite that they changed structure model they still highlight some pros with the closed-end Limited Partnership structure. For instance they mentioned that this structure is easy to manage when it comes to institutional capital, where the investors want a clear exit for theirs investments. In other word they simply require this structure. They mean that the Evergreen structure is more suitable for private investors such as family offices and wealthier individuals that strive to create a long-term wealth.

Another respondent’s view on the two different structures is that the Evergreen structure is suitable investors that seek companies to invest in that generate high cash flows in a long term perspective. The respondent also mentioned that this structure is less depended on how the market performs in general, compared to the closed-end Limited Partnership structure. As for the closed-end structure the general partners have more to lose due to the fact that they have to raise new funds which require that they have a well-performed track record from managing previous funds. The conclusion from this respondent is that they have different views on exit, when it comes to choosing between the structures.

When looking at Crowd Funding structure the overall opinion from all of the respondents is that the structure is not appropriate for institutional investors. It seems rather unprofessional with a very high risk for the investors. The figure below represents a summary of this section where pros and cons between the Evergreen structure and the closed-end Limited Partnership structure are highlighted.

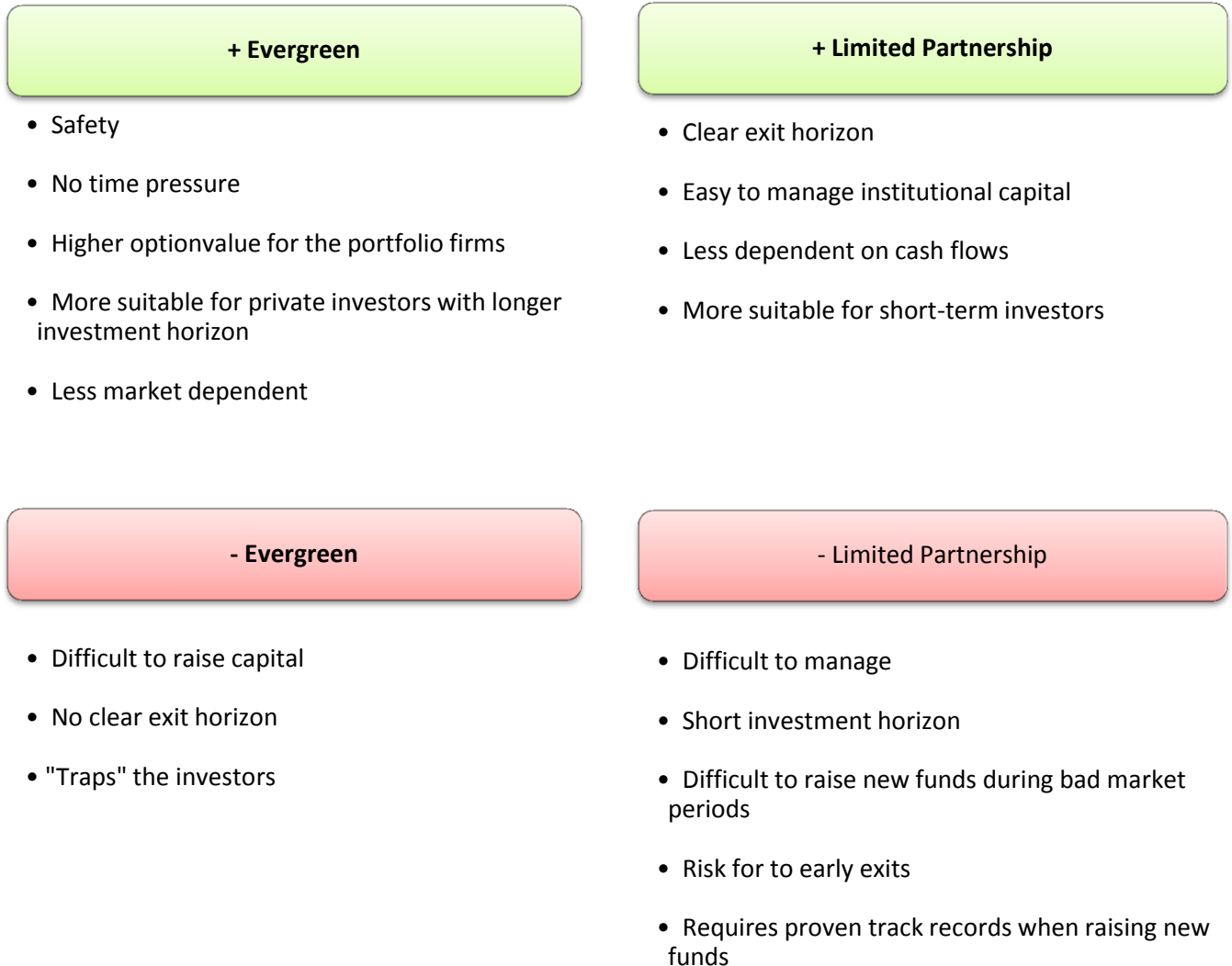


Figure 8. Comparison between Evergreen and Limited Partnership structure

4.1.7 Syndicated investments

It may happen that different actors collaborate and invest together in so called syndicated investments, despite their differences in strategies. According to several respondents there are many reasons for syndicated investments, for one Evergreen respondent it may occur in extremely rare cases where they actually strive for exiting an investment, and are looking for backup investors with the same purpose. Syndicated investments are also good in the cases where it is difficult to raise capital or in the cases when you want to have a more branch-specific model. The respondent mentioned that they appreciate the competence that Business Angels possess, but a partnership is associated with a risk and a possibility that the Business Angels drop of the investment when it best suits them, which can be too early for other investment partners. This structure of syndication became a trend in Silicon Valley where many actors comes together to find and achieve a faster growth in capital-intensive investments.

When asking a more neutral respondent they claims that syndicated investments are typical for the Swedish behavior where you as an investor wait on other investor to take decision for a particular investment. In other words the Swedish investors are typically cautious before taking an investment decision, which is a contributing factor that many investments are syndicated in the Swedish Venture Capital industry. This can also be confirmed by other respondents who claim that syndicated investments decrease the overall investments risk. Another major motive for syndicated investments is to minimize the information asymmetry. When it comes to syndications it is important that all investors have the same preferences and level of commitments, since they are to work in teams. It is also easier for the investors to be bought out and exit the investment when other investors are involved. The respondent claims that it is favorable when the investors know each other, since it build mutual trust and commitment. On the other hand the drawbacks with syndicated investments are the risks for diverge ideas and discussions. A “greater democracy” can also mean that there will be more discussion rather than decision-making, and therefore there will be no decision made in any direction. In other words a diversified ownership includes various egos, which make it extra important to have a good management structure, this according to one respondent. A diversified ownership might require that the investors deviate from their initial core values and principles, in order to adapt and collaborate with other investors.

To avoid dramatic and disadvantageous syndications one respondent says that the VC companies can sometimes clear out other investors and owners. This is done if the VC firm wants to have a less diverse ownership structure, and avoid the problems that syndicated investments brings with them.

The overall opinion for our respondents regarding Crowd Funding is that diverse ownership of such nature is acceptable when the majorities of the owners are inactive or have signed an agreement on how they are allowed to act as owner within the company.

Observe that the statements above are taken from actors within the Swedish VC market, and no comparison has been made for any other countries.

5. Analysis and summary of findings

5.1. Equity gap

The study shows that the equity gaps are still problems within the Venture Capital industry. Throughout the study, three different equity gaps can be demonstrated. The first gap is referred to the gap between Venture Capitalist firms and Business Angels. This gap occurs when the entrepreneur wants to take the business to the next level from the start-up phase to expansion phase (see figure 3, the company funding chain). It can be a problem because the entrepreneurs company might be too small to be seen as an attractive investment for a Venture Capital firm, and hence having problems reaching the “next step” seeking funds from other sources than Business Angels. One way to tackle the first gap is through syndicated investments. This type of investment structure have become more frequent during the last years, even though there are not any existing model that handle all the different type of actors.

The second gap is referred to exit problem for seed and early stage Venture Capitalists and their portfolio companies, where the portfolio company is in need for continued funding after the initial Venture Capital period has ended (Murray, 1994). Venture Capitalists firms solve the second equity gap by using the Evergreen structure where the main goal is to generate high return without any time pressure to make exits.

We have also observed a third gap, which we think occur between private investors with low investment capacity and early stage companies. This gap however only occurs when there is an existing need for smaller private investors to invest in early stage start-ups. This gap can be tackled by the new financing source, named Crowd Funding. Crowd Funding can also be seen as a way to tackle the first gap where the bridge between early stage capital and Venture Capital is filled by the help of a crowd of investors. However, our study can confirm that Crowd Funding can be a problem when it comes to get Venture Capital funding in early stages. Crowd Funding create a diverse ownership structure that is unattractive for the professional Venture Capital firms, in other words it may scare away potential formal Risk Capital investors.

5.2. Future industry development

The Swedish Venture Capital industry faces several radical changes and difficulties. Our study can confirm that there is a demand for using both an Evergreen Venture Capital structure as well as a closed-end Limited Partnership model. Both structures are suitable for different kind of investors. The prime factor between these two structures is the view on exit, in other words the investment horizon. The long-term investors will probably choose an Evergreen-structure while a short-term investor will choose a closed-end Limited Partnership structure. More institutional investors are now changing from a closed end Limited Partnership structure to an Evergreen structure. The study also shows that there is a clear demand on both of the structures. This demand will probably remain in the near future. As the Evergreen fund structure becomes more common in the Venture Capital industry, it will attract actors such as family offices which mainly strive to have a positive perpetual cash flow on their investments.

Regarding the new financing structure, Crowd Funding, there is obviously a clear demand in these types of investments. However this structure cannot be seen as a professional Risk Capital funding structure due to the missing due-diligence process, the small share of ownership offered, and the diverse ownership. The overall opinion is that Crowd-funding will not be a substitute to the main financing structures within the Venture Capital Industry. It will work more as a source for charity, marketing and for funding the project that are ignored by Business Angels.

This study indicates that the behavior of market actors already has underwent some radical changes and will continue to do so over the near future. For instance the risk-aversion will be at a higher level, meaning that the Venture Capital firms will not gamble in the same extent as they did before. This behavioral change implicates that the VC actors are more willing to create syndicated investments with other market participants. These types of syndications will lower the individual risk for each actor. The interpretation of our interviews with the VC market actors indicates that the overall opinion is that the number of active Venture Capital firms will continues to stay at the same low number. The Swedish Venture Capital market will become more mature and professional since this is necessary for its survival and continues growth. The professionalization of the Venture Capital market will spread further to other segments within Risk Capital. For instance the role of Business Angels will change to an even more professional actor within the market. As mentioned in this paper, angel investors will work more in teams and

so called “networks”. Trends show that angel networks have become bigger in scale and also more formal when it comes to searching for new ventures and investment opportunities. Angel networks will become more similar to Venture Capital firms in their working procedures. In other words this means that the demarcation between formal and informal Risk Capital will become slightly vague.

5.3. Economic consequences

Venture Capital represent a significant and important part for the development of SME (Small and medium enterprises) businesses and hence plays an important role in a nation’s economic growth. As Venture Capital firms and actors becomes less willing to take risk, this will result in fewer companies getting funding, also being overall disadvantageous for new entrepreneurs. However this trend will possibly filter the market from both unprofessional investors and less profitable entrepreneurial ideas.

Legal aspects such as the problem with employee-option taxation are something that inhibits the development of the Swedish Venture Capital industry, and hence indirectly the growth of the Swedish economy.

6. Conclusion

The Swedish Venture Capital industry has undergone some fundamental changes since the aftermath from the Dotcom-crash. First of all the number of active VC-firms have decreased greatly, where the minor and unprofessional actors have been filtered from the market. Secondly our study shows that the industry is affected by several structural changes. The trend has been to change from the more traditional closed-end Limited Partnership structure to the Evergreen fund structure. The main motives are mainly based on the changed behavior of the Venture Capital industry actors. For instance one of our findings shows that the majority of the Venture Capital firms prefer stable and long-term investment portfolios rather than “flipping” high risk investments. This statement however excludes Business Angels that might strive for “homeruns”, which means investment with extremely high risk that might generate an extremely high return. Another major motive is that the investors have changed their risk-profiles to being more risk-averse, which force the Venture Capital firms to make strategic changes in their way of work. Therefore some of the VC-firms prefer using an Evergreen fund structure without focusing on exit, but instead focusing on the investments that are profitable in a longer term.

Based on our findings the overall conclusion is that the VC-model is in some sense broken. The market is handling and adapting to this by introducing the Evergreen fund structure to the VC market and also by introducing another minor form to the risk capital markets such as Crowd Funding. Another adjustment in the market is that Business Angels are acting more as formal Venture Capital, in the form of angel networks. The Swedish entrepreneurs are seeking not only capital in terms of funding but also capital in terms of knowledge which put pressure on the VC firms to become more professional.

Syndications are now becoming more frequent when financing new ventures. Two great Swedish examples of successful syndications are Spotify and iZettle. We believe that syndications may help to professionalize the Swedish Venture Capital industry and to reduce the overall risk within the Swedish Venture Capital market. As described in this paper the individual investor risk will be diversified away and therefore reduced in each investment. Our opinion is

that syndications will benefit the entrepreneur since it becomes easier to raise capital for new ventures.

We believe that after years of declining returns in the Swedish Venture Capital industry, there might currently be a turning point in sight. This is something that we highlight in this thesis. The actors are currently adapting different financing structures and strategies to the new market conditions. As mentioned in this paper, the risk-aversion is adjusting to the real and actual underlying risk within the market. However, there is still space for further studies with a more quantitative perspective, for instance evaluating the actual returns, profitability and risk of Venture Capital investments.

Finally, our study shows that the legal-system, regulating the Swedish Venture Capital industry, must undergo some major changes. This implies that the future development of the Swedish Venture Capital industry lies not only in the hands of the market actors, but also in the hands of the politicians and regulators. This is something that also might open up for further studies, with a more legal approach.

6. Bibliography

6.1 Written sources

Barney, J.B., Fiet, J. and Moesel, D. (1994). *The relationship between Venture Capitalists and managers in new firms*. *Managerial Finance*, 20:19-30.

Barnes, S. and V. Menzies (2005). *Investment into Venture Capital funds in Europe: An explanatory study*. *Venture Capital*, 209-226.

Belleflamme, P. Lambert, T. Schwienbacher, A. (2012). *Tapping the Right Crowd*, Université catholique de Louvain.

Berger, A. Udell, G. (1995). *Relationship Lending and Lines of Credit in Small Firm Finance*. *Journal of Business* 68, 351-381

Damodaran, A. (2002). *Investment valuation: tools and techniques for determining the value of any asset*. New York: Wiley.

Engbretsen, O., Lundberg, K. (2000). *The Venture Capital investment decision process*. Master's Thesis in Financial Economics, Stockholm School of Economics.

Eisenhardt, K, M. (1989). *Agency Theory: An assessment and Review*. *The academy of management review*, vol 14, p57-74.

Gilligan, J. and Wright, M. (2010). *Private Equity demystified: An explanatory guide. Second edition*. ICAEW Corporate Finance Faculty, London.

Gompers, P.A. Lerner, J. (2004). *The Venture Capital Cycle*, MIT Press, 2nd Revised edition.

Gompers, P.A. and Lerner, J. (1999). *Conflict of interest in the issuance of public securities: Evidence from Venture Capital*. *Journal of Law & Economics* 42(1):1-28.

Isaksson, A. (1999). *Effekter av Venture Capital i Sverige (Effects of Venture Capital in Sweden)*. , NUTEK B 1999:03, Stockholm: NUTEK

Isaksson, A. (2000). *Venture-capitalföretags finansiering av tillväxtföretag*. Unpublished Working paper. Umeå School of business and economics.

Isaksson, A. (2006). *Studies on the Venture Capital process*. Umeå School of Business, Umeå University

Isaksson, A. (2010). *Staten som Venture-capitalist: en sammanställning av internationell empirisk forskning*, Tillväxtanalys, Österund PP 33-84.

Kaplan, S. N and Schoar, A. (2005). *Private Equity performance; Returns, persistence and capital flows*. Journal of Finance, 60(4).

Kaplan, S.N. Lerner, J. (2010). *It Ain't Broke: The Past, Present and Future of Venture Capital*. Journal of Applied Corporate Finance, 22: 36-47

Kedrosky, P. (2009). *Right-Sizing the U.S Venture Capital Industry*, Ewing Marion Kauffman Foundation.

Landström, H. and Manigart, S. and Mason, C. and Sapienza, H. (1998). *Contracts Between Entrepreneurs and Investors: Covenants and Negotiation Process*. Babson-Kaufman Annual Conference, Gent, Belgium.

Lerner, J. (2000). *A brief review of Venture Capital and Private Equity: A casebook*. Toronto: John Wiley & Sons.

Mason C. M., and Harrison R., T. (2008). Developing Time Series Data on the Size and Scope of the UK Business Angel Market. *BERR*

MacMillan, I. C., Siegel, R. and Narasimha, P.N. (1985). *Criteria used by Venture Capitalists to evaluate new venture proposals*, Journal of Business Venturing, 1(1):119-128.

McNally, K., (1997). *Corporate Venture Capital: Bridging the equity gap in the small business sector*. London: Routledge.

Movin, S. Plogner, A. (2010). *Mobilisering för innovation – Studie baserad på diskussioner med 10 koncernledare i ledande svenska företag*, VINNOVA

Murray, G., (1994). *The Second 'Equity Gap': Exit problems for Seed and Early Stage Companies and Their Investee Companies.* International Small Business Journal.

Norton, E. and Tenenbaum, B. H. (1992). *Factors affecting the structure of US Venture Capital deals.* Journal of Small Business Management 30, 20–29.

Phaliippou, L. and Zollo, M. (2005). *What Drives Private Equity Fund Performance? University of Amsterdam.* Faculty of Economics and Econometrics.

Rask, D. (2010). *Venture Capital investeringar I Cleantech-bolag I Sverige – Klassificering och kategorisering av Svenska Cleantech-bolag.* Umeå School of Business, Umeå University.

Regeringskansliet. (2012). *Den nationella innovationsstrategin.* Regeringskansliet.

Regeringen. (2012). *Regeringens proposition – Investeraravdrag, prop. 2012/13:134* Finansdepartementet.

Sahlman, W. (1990). The structure and governance of Venture Capital organizations. *Journal of Financial Economics*

Sorenson, O. and Stuart, T.E. (2001). *Syndication Networks and the Spatial Distribution of Venture Capital Investments.* The American Journal of Sociology 106(6):1546-88.

Söderblom, A. (2012). *The current state of the Venture Capital industry,* Näringspolitiskt Forum rapport nr 2.

Söderblom, A. (2011). *Private Equity fund investing: Investment strategies, entry order and performance.* Doctoral Dissertation. Stockholm School of Economics

Sweeting, R (1981). *Internal venture management analytical aspects.* Journal of General Management 7(1):34-45

Venkataraman, S. (1997). *The distinctive domain of entrepreneurship research.* Adv. Entrepreneurship Research, Firm Emergence Growth 3:119-138.

Volberda, H.W. and Lewin, A.Y. (2003). *Co-evolution dynamics within and between firms: from evolution to co-evolution.* Journal of Management Studies 40(8):2111-2136.

Yung, C. (2009), *Entrepreneurial Financing and Costly Due Diligence*. Financial Review, Vol. 44
Issue 1, p137-149

Öun, M. and Pettersson, I. (2012). *Critical factors for successful Strategy Formation in Venture Capital Funded Companies: a study made for SEB Venture Capital*. KTH Industrial Engineering and Management

6.2 Verbal sources

Falkenvall, Martin. Partner and investment director, *Eterna invest AB*, March 14th 2013, Stockholm

Katzenellenbogen, Daniel. COO, *Serendipity Innovations*, March 12th 2013, Stockholm

Nilsson, Peter. Business Angel/Partner, *Stockholms Affärsänglar*, March 6th 2013, Stockholm

Rahmn, Jonas. CEO, *KTHCHALMERSCAPITAL*, March 19th 2013, Stockholm

Sjögren, Martha. Partner, *Northzone*, March 13th 2013, Stockholm

Talborn, Henrik. Chief Economist, *Swedish Private Equity and Venture Capital Association*, March 18th 2013, Stockholm

Åsklint, Cathrine. Mentor & Project Manager, *FundedByMe*, March 19th 2013, Stockholm

6.3 Web based sources

Corporate livewire "The History of Private Equity & Venture Capital" (2012). Available at: <http://www.corporatelivewire.com/top-story.html?id=the-history-of-private-equity-venture-capital> (Accessed February 3th 2013)

European Venture Capital Association, "Venture Capital" (2013). Available at: <http://www.evca.eu/toolbox/glossary.aspx> (Accessed March 7th 2013)

Harvard Management Company "A unique investment model" (2013). Available at: http://hmc.harvard.edu/investment-management/hybrid_model.html (Accessed March 3th 2013)

Institutionen för entreprenörskaps- och småföretagsforskning "Affärsänglarna flockas i storstäder" (2007). Available at: http://www.esbri.se/referat_utskrift_popup.asp?id=67 (Accessed February 2th 2013)

Inside the Firm "A Brief History of Private Equity" (2009). Available at: <http://www.jobsearchdigest.com/insidethefirm/137/a-brief-history-of-private-equity/> (Accessed February 3th 2013)

Institutional Investor "New Private Equity Vehicle To Better Align GP with LPs" (2012). Available at: <http://www.institutionalinvestor.com/blogarticle/3095570/Blog/New-Private-Equity-Vehicle-To-Better-Align-GP-with-LPs.html> (Accessed February 17th 2013)

Internetworld "Så lyckas du med crowdfunding" (2012). Available at: <http://www.idg.se/2.1085/1.445262/sa-lyckas-du-med-crowdfunding> (Accessed February 11th 2013)

Investopedia "Definition of Family Offices". Available at: <http://www.investopedia.com/terms/f/family-offices.asp#axzz2LYrXj9o> (Accessed February 20th 2013)

Konjunkturbarometer "Rapport, Konjunkturinstitutet" (2012). Available at: (Accessed November 15th 2012)

National Venture Capital Association "VC Industry Overview" (2013). Available at: http://www.nvca.org/index.php?option=com_content&view=article&id=141&Itemid=589 (Accessed February 2th 2013)

The Business Journals "Time for a new VC model" (2008). Available at: http://www.bizjournals.com/seattle/blog/techflash/2008/11/Guest_Post_A_new_VC_model34447694.html (Accessed February 17th 2013)

The Swedish Private Equity & Venture Capital Association (SVCA) "Business Angel networks" (2013). Available at: <http://www.svca.se/en/About-VC/About-VC/Angels-venture-and-buyout---who-is-who/Business-Angels/> (Accessed March 6th 2013)

6.4 Other non-referred sources

Ohlsson, Lennart. Co-Founder, *Stockholms affärsänglar, STOAF.*

Sonnek, David. Global Head, *SEB Venture Capital.*

7. Appendix

7.1 Interview questions - Swedish

1. Vad är er roll på företaget och hur ser er bakgrund ut?
2. Berätta gärna lite kort om ert företag och hur ni arbetar?
 - a. Hur ser er finansieringsmodell ut och hur är den strukturerad?
 - b. Vilka typer av investeringar gör ni? Brukar ni avvika från er strategi?
 - c. Hur stor brukar er genomsnittsinvestering vara?
 - d. I vilket stadie befinner sig vanligtvis företaget som ni investerar i? Det vill säga är det i idéstadiet eller är det i redan etablerade produkter och tjänster?
 - e. Hur ser er investeringshorisont ut?
3. Beskriv branschens utveckling sen Dotcom-kraschen. Vilka är de stora skillnaderna då mot nu?
4. Vilka är de nuvarande trenderna som kommer påverka den framtida utvecklingen av riskkapitalfinansiering? Vilken utveckling förväntas ske inom de kommande åren (1-5)? Hur ser ni på framtiden för de olika finansieringsformerna?
5. Hur ser de legala aspekterna ut, dvs. finns det några regleringar som har påverkat PE-marknadens utveckling de senare åren?
6. Vad är motiven för entreprenören att välja er som investerare?
7. Vilka krav/kriterier ställer ni på era investeringar?
8. Hur aktiva är ni i era investeringar? Hur följer ni upp dem?
9. Hur riskbenägna är ni vid val av investering?
10. Vad är incitamenten till att byta från standardiserade Limited Partnership (closed end funds) till Evergreen funds.
11. Hur ser för- resp. nackdelar ut med respektive modell?

12. Hur hanteras dramatiska ägarstrukturer dvs. samarbeten mellan olika finansieringsstrukturer och aktörer? Vad är motiven för att kombinera olika ägarstrukturer?

7.2 Interview questions - English

1. What is your role at the company and what is your background?
2. Tell us about your company and how you work in practice?
 - a. What is your financing model and how is it structured? (Evergreen, closed-end etc.?)
 - b. Which typ of investments do you make? Do you sometimes deviate from the strategy?
 - c. What is the size of your average investment?
 - d. In what stage is usually the company that you are investing in? Is it in the development stage or do they already have established products and services?
 - e. What is your investment horizon?
3. Describe the development of the industry since the Dotcom-crash. What are the major differences now compared to then?
4. What are the current trends that will affect the future development of Venture Capital financing? What kind of development is expected within the next few years (1-5)? How do you see on the future for the various forms of financing?
5. How do the legal aspects look like? Are there any regulations that have affected the development of Venture Capital industry?
6. What are the motives for the entrepreneurs to choose you as an investor?
7. What requirements/criteria do you have on your investments?
8. How active are you in your investments? How do you follow up these investments?
9. How risks averse are you in your investments?
10. What are the incentives to switch from the standard Limited Partnership model (closed end funds) to an Evergreen fund structure?
11. What are the advantages and disadvantages with respective model?

12. How do you handle "dramatic ownership structures" ie. syndications between different actors and structures? What are the motives for combining different ownership structures?