



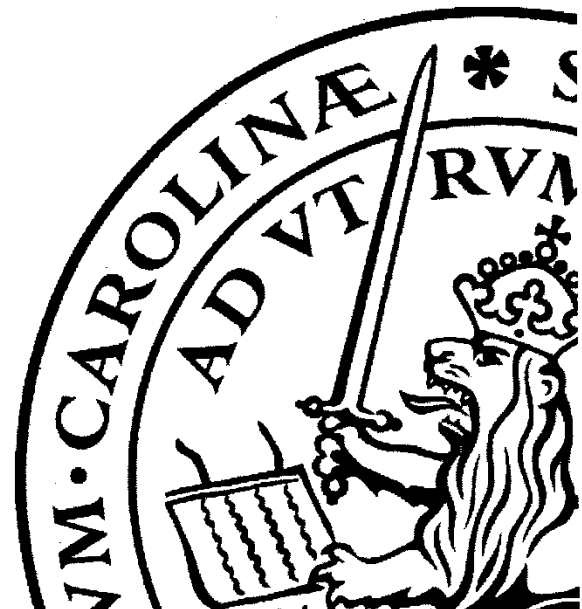
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# Intellectual Capital in the Venture Capital Industry



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## Abstract

Title	Intellectual Capital in the Venture Capital Industry
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Authors	Marcus Ramstrand, Carl Richter
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5 key words	Intellectual Capital, Venture Capital, Knowledge Theory, Due Diligence, Knowledge firm
Purpose	Answer the question: Is the present venture capital firm IC-consideration satisfactory when evaluating investment opportunities?
Methodology	The study is conducted with a deductive approach where a qualitative method is used to find the answer of our purpose. The research design used for this is problem analysis, where we have analyzed the views of a number of respondents through interviews.
Theoretical Perspective	The study is based on the theories of Intellectual Capital, Venture Capital, Knowledge theory and due diligence
Empirical Foundation	The thesis has its base in a number of semi-structured interviews with Venture Capitalists, Entrepreneurs and other, supporting, respondents
Conclusions	Our conclusions point to that the venture capital firms take intellectual capital in consideration in a satisfactory way. They do not however evaluate these in a structured quantitative way, but instead utilize a qualitative, unstructured, evaluation in order to ensure the quality of the factors. We see no added value in using a more structured IC-framework, as the VCs have such a unique insight in their investment opportunities and that every opportunity is unique, why a framework is difficult to use. Our conclusion is that the intellectual capital factors are determinative whether the venture capital firms are to invest in a venture or not, and that the more quantitative due diligence is then utilized in a later stage to determine the size of the investment. Lastly, the IC-factors do affect the value of the investment opportunity.

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# 1 Introduction

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*In this introduction we will present a background to our chosen subject, and then present a problem discussion drawn from this background which in turn will render the purpose of this thesis. We will end the chapter by presenting the limitations this thesis faces and the perceived target audience.*

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## 1.1 Background

Many have heard the old cliché about what is most important in real estate — "location, location, location." For many venture capitalists, it's "management, management, management." ([www.allbusiness.com](http://www.allbusiness.com), 2010). This implies a strong focus on the management, but how is this factor considered, and does this mean the other factors of intellectual capital are neglected?

Venture capital (henceforth VC) is a type of private equity capital investment provided for early stage companies that have high growth potential. VC typically comes from institutional investors or rich individuals that are looking for an exit from this investment normally within five years. The kind of exits investors are looking for are either an initial public offering (IPO) or a trade sale. An IPO is when the company sells its shares to investors on a stock exchange and a trade sale is when the company is sold to another incumbent. The most common companies to be backed by VC are companies in high technology industries such as biotechnology or information and communication technology (ICT) (<http://vcexperts.com/>, 2010).

A VC can carry only a handful companies in his portfolio since the relationship between the VC and his investment is of a quite time consuming character. The relationship is of this character since the investment from the VC is often expected to be not only by financial means but also of managerial and technical expertise. Early stage companies that wish to raise VC require a very rare but sought after combination of skills such as innovative technology and an impressive management team. A skill that is very important for the VC to possess is then to be able to identify which companies have the technologies that can lead to a break through and which companies that have entrepreneurs that are capable of running a high growth company (<http://vcexperts.com/>, 2010).

VC is very important for society. Although high growth companies can be found in many industries and sectors there are some indicators that the companies with the highest growth potential are knowledge-based and technology driven, i.e. they are based on intangible assets (Landström, 2007). As these companies often do not have any assets to borrow against it is hard for them to get access to capital which then constrains their ability to grow (Brophy, 1997). The second big factor constraining their growth is access to competence, experience and networks (Brophy, 1997).

It is because of these constraints that an economy needs a well developed VC market to fill this gap of financial capital and managerial skills. The U.S. economy is a good example: it has often been argued that it is due to the well developed U.S. VC market that the U.S. economy historically has had the ability to turn innovative ideas from universities and R&D laboratories into high growth companies. Concrete facts for this can be found in NVCA's Venture Impact report where it is stated that 11% of private sector employment in the U.S. and 21% of national U.S. GDP in 2008 came from VC-backed companies (NVCA, 2009). Examples of U.S. companies that have been VC-backed are giants such as Microsoft, FedEx, Google, Intel, Apple, Starbucks, eBay and Facebook (NVCA, 2009). With these facts it is easy to say that growth oriented ventures are important in society, and VC is an important part in helping these ventures achieving growth.

Since the companies with the highest growth potential often are based on intangible assets, it implies that it should be very useful to have a way of appreciating and measuring these intangibles. Traditional models of accounting are failing to keep up with the revolution of businesses. As the economy has been moving towards one where intellectual capital (henceforth IC) is increasingly determining the value of a company, corporate financial documents are having a hard time keeping up with the modern organization as current reporting methods are too static and hidebound to incorporate this. The market values of companies and their value according to accounting are getting more and more disperse and indicates that this difference is not just temporary, but that there is a deep-seated inconsistency between the story one can read about in the corporate financial documents and what actually matters in the real corporate world. The signs of this can be seen every day in business papers and magazines as news about access to or loss

of knowledge and IC makes the stock prices of companies turn like a roller coaster (Edvinsson, 2002).

The implication of accounting methods becoming obsolete is that annual reports and other sources of reporting that companies conduct tells us nothing about which companies have sustainable organizational capabilities (Johnson et al, 1987). This gap between accounting value and the value perceived by the markets have created an inefficient market where wealth can be captured if other ways of measuring and identifying knowledge and intellectual property can be developed. At the same time as some become very wealthy from developing these skills, the lack of common practices for disclosing IC hurts stakeholders and investors. Small investors, who only have the annual report, other corporate reports, financial papers and magazines to use in their evaluation of a company, will impossibly be able to identify which companies have the IC needed to be successful in today's corporate world. Furthermore, the lack of ways to disclose and appreciate IC hurts many companies as they do not realize the potential they have. This is of course negative not only for the company but also for the society as a whole as it leads to unemployment, reduced productivity and reduced national competitiveness (Edvinsson, 2002).

## **1.2 Problem discussion**

In an economy where intangibles and knowledge is the basis for competition, the implications is not only that hidebound methods of accounting becomes inexact, but also that investors and other stakeholders need to appreciate other measures of a company in order to make a more precise evaluation. One example of this is when VCs try to appreciate the potential of a start-up: the most important factor in the decision on whether to invest or not is the trustworthiness of the entrepreneur and the perceived knowledge and skills of the management team (Sudek, 2007). It is thus very important for the VC to be able to recognize which technologies and which entrepreneurs have the sought after traits and skills. There are many examples from history where brilliant inventions have been neglected due to insufficient knowledge on behalf of investors. Photoshop is one such example where the software was turned down by several companies before it was presented to Adobe and they liked it ([www.storyphoto.com](http://www.storyphoto.com), 2010). The fact that Photoshop was turned down, and that similar events probably happen all the time is not necessarily bad, since if a company or a VC cannot see the potential in a product or a start-up



company, they would probably not be able to make it successful either. But if start-ups that are looking for VC financing and knowledge are turned down because VCs do not evaluate them in a way that properly incorporates IC, then business ideas that could become successful in the new knowledge economy might slip through the cracks.

### **1.3 Purpose**

Based on the problem discussion above, the aim of this thesis is to research how venture capital firms take IC into consideration at present, how this affects the valuation of the investment opportunities and also investigate whether structured IC-framework would be value adding. Our purpose is therefore to answer the following question:

Is the present venture capital firm IC-consideration satisfactory when evaluating investment opportunities?

### **1.4 Limitations**

When conducting this study, we will limit ourselves to focus on VCs and their due diligence process when they evaluate start ups. All VCs we will interview will be Swedish. Furthermore, when evaluating a due diligence (henceforth DD) template, we will limit ourselves to look at only one template (exhibit 1) although, in reality, the due diligence process is unique for every company. Lastly, even though there are multiple theories regarding IC, where InCas is one of the more prominent, we will limit this thesis to the use of the theories put forth by Edvinsson et al and EFFAS.

### **1.5 Target Audience**

This thesis is mainly targeted at VCs as we believe the results of this thesis can be utilized in their strategy regarding due diligence. The thesis is of course also targeted to the academic world where we hope that students and professors will find this work on VC and IC interesting.

## 2 Method

- In chapter 2, information on the method of reaching our results will be disclosed. In addition to presenting the methods we have chosen we will also present an argumentation on why these methods were chosen.

## 3 Theoretical Framework

- In this chapter we will present the theories which will later be used in order to conduct our analysis. Initially we present why these theories were chosen, and following this we present the theories to the extent needed in order to analyze the situation in coherence with the purpose of this thesis.

## 4 Empirics

- In chapter 4 we will present our findings during our data collection, which is later to be analyzed. This data involves interviews with venture capital firms, entrepreneurs and business angels. The data is summarized by category and respondent. Note that the interviews were held in Swedish and the presentations therefore are translated by the authors of this thesis.

## 5 Analysis

- In this part we will firstly present a disposition of our analysis. We will then move on by analyzing our empirics using the theoretical framework presented in chapter 3. The analysis will begin with our view on the understanding of IC among the respondents and then continue to describe our analysis on the historical development and present situation. The chapter will be ended by an analysis of the need for a framework to account IC among VCs and the effect the present consideration of IC-factors has on the valuation of an investment opportunity.

## 6 Conclusion

- In this chapter we present our conclusions based on the conducted analysis. This conclusion will be the basis for the key takeaways presented. Afterthought and retrospection will also be presented, which has the purpose to be able to present suggestions for future research on the subject and also to describe the knowledge journey we have traveled while writing this thesis.

## 2 Method

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*In chapter 2, information on the method of reaching our results will be disclosed. In addition to presenting the methods we have chosen we will also present an argumentation on why these methods were chosen.*

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### 2.1 Methodological Framework

In this study we will utilize a deductive approach in order to reach our conclusions, apparent through our used argumentations. Premises are put forward and from these conclusions are drawn. The process of drawing conclusions from premises will provide us with conclusions containing deductive backing. This creates a relationship between the premises and the conclusions which suggest that the conclusions are bound to be correct assuming the premises are correct (Dahlman, 2007). The same holds true for the opposite scenario; if the premises are not correct then this will result in an incorrect conclusion, why a critical analysis of our theories and empirics are necessary in order to present correct premises.

Using a deductive approach implies that we will utilize a number of theories in order to make observations which will provide us with results. These results will then be analyzed and used to make conclusions. Provided that we do not have the objective to propose new theories, but analyze a current situations based on already existing theories, we are not using an inductive approach. The theories we will utilize have been chosen prior to the research process, which also is an argument why we are not using an inductive approach, due to the fact that researchers using an inductive approach should aim to be as objective as possible in relation to the research objects in order to create new theories (Bryman et al, 2005).

### 2.2 General Method

Initially we intended to combine a qualitative and a quantitative research method in order to maximize the informational foundation we could base our analysis upon. The qualitative approach seemed rather obvious in form of documentation studies and interviews but however we soon met obstacles regarding the quantitative research. Intellectual capital is by nature a rather qualitative concept and earlier research has had difficulties defining it in quantitative terms in a

meaningful way. Based on this we have chosen to disregard the quantitative approach. We have therefore chosen to concentrate our research on a qualitative, interpretative, approach where we base our analysis on various empirics, where interviews will be the main source. This approach implies a low degree of formalization and is primarily used with the intent to provide insight and understanding (Bryman et al. 2005). Our focus is not to test the information for general validity, but the main focus is instead the ways we collect our information. The purpose of the information collected will be to provide us with a deeper understanding of the defined problem at hand and to describe the entirety of the context in which this problem is embedded (Holme et al, 1996). The reason why we chose this standpoint is because it to the highest degree corresponds to our problem definition. The advantage of a qualitative research method is that we have access to large amounts of data through documents and interviews, which then can be interpreted in order to conduct our intelligible and theoretical work. A disadvantage with the method is that is difficult to present a definitive answer to our problem definition, which implies that the interpretations we present reflects the reality as we see it.

### **2.2.1 Concepts within qualitative research**

The debate whether to use definitive or sensitizing concepts is based on the notion that definitive concepts, which are rigid when once formulated, can result in a situation where we as researchers become limited in our ability to conduct a thorough analysis. The reason why we do not use definite concepts is because concepts within intellectual capital might get a too narrow definition. This could result in the primary data we collect being affected to much by our subjective reality. Sensitizing concepts, which instead provides “*a general sense of reference and guidance in approaching empirical instances*” (Blumer, 1957, s. 7), could on the other hand result in a too broad concept framework which provide little guidance if the concepts are too undefined to be utilized in the analysis. Despite this we have chosen to utilize sensitizing concepts, where we have not in advance defined how we view the social reality. Instead we have chosen to concentrate on a description which will be revised and narrowed continuously during our data collection. The advantage with this approach is that it initially does not limit our interpretation and that future researchers can utilize our concepts and revise these further in relation to differing social situations observed and differing problem definitions.

### **2.2.2 Suggestions to alternative research methods**

If we had access to the venture capital firms complete due diligence processes, including their monetization of intellectual capital concepts it would be preferable to include a quantitative research method. This method could more precisely define the importance of intellectual capital concepts within the due diligence process and mitigate the problematic situation of having to discuss the research objective in theoretical terms. We would therefore recommend future researchers, with access to more time and data, to conduct a quantitative study.

### **2.3 Research Design**

As the DD-framework is a tool for investigating companies' competitive advantage we have found that due to copyright issues they are unable to provide us with a detailed description of how their individual DD-framework is structured. Initially our strategy was to gather multiple such DD-frameworks and critically analyze these in order to observe how they incorporated intellectual capital. However, as this is not possible we have revised our research design to defining a general DD-framework and combining this with qualitative interviews with representatives from multiple Venture Capital-firms in order to conduct a meaningful analysis. As a result we have chosen to conduct a problem analysis, where the problem to be analyzed is the extent of IC measurement the VCs conduct and their view of the importance of this. An advantage of using input from interviews with multiple representatives is that we are not bound by the findings of one single observation and that we therefore have the possibility to analyze the case based on different study objects and through this gain insight from different perspectives. Choosing this design increased the ease of the studies radically as most Venture Capital firms tend to focus on specific industries or types of companies, which could impede our results. Furthermore the individual firm could choose not to disclose their name and be anonymous in order to mitigate the problem of supplying potential trade secrets of their specific DD-framework. We assume that this will increase the trust towards us as researchers and open up for a more comprehensive discussion which might not be possible when studying a specific venture capital firm.

## 2.4 Data Collection Method

### 2.4.1 Primary Data

Primary data is information collected with the intention to be used specifically in relation to the objective at hand. It is collected in relation to the report and is intended to be used as a basis for achieving the research objective. Primary data can be collected through many different sources and in many different forms, in the report and hand we have chosen to focus our primary data collection to interviews.

#### 2.4.1.1 Interviews

An interview can be constructed in multiple ways; structured, unstructured and semi-structured (Bryman et al. 2005). Based on the objective at hand we have chosen to conduct semi-structured interviews. This interview method implies that we have defined a number of main topics with sub-questions to be asked. The semi-structured interview allows us to ask attendant questions related to the respondents previous answers. These answers can give us new point of views and an increased informational depth than we previously had. One of the main concepts regarding semi structured interviews is flexibility, which allows the respondents to freely address their specific topics of interest. The flexibility can also be utilized by the researcher as it gives them the possibility to further elaborate on the main or sub-topics or on the new topics of interests which the respondents reflect upon (Bryman et al. 2005). As the topic, IC, of this thesis is a rather new concept to which the respondents have different, if any, approaches we have put much emphasis on the possibility for the respondents to be open and elaborate on their thoughts, and also that we as researchers should have the possibility to touch upon different topics arising during the interview process. We feel that this possibility is provided by flexibility the semi structured interview offers, why we have chosen to utilize this interview method.

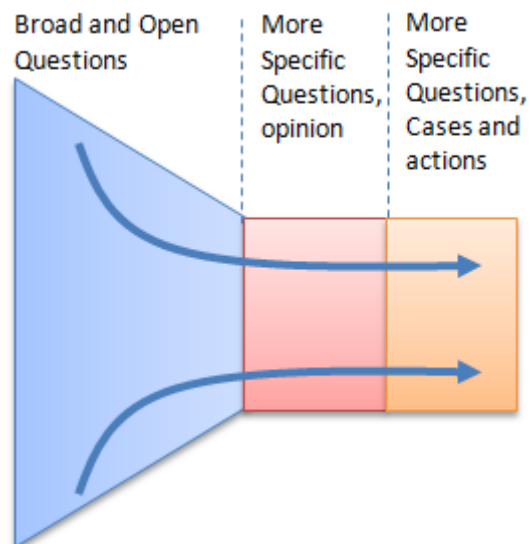
We have chosen to conduct telephone interviews with our respondents due to various reasons. Our personal economic situations prohibit us from travelling across Sweden to conduct the interviews. As the time within this thesis is to be conducted also is a restricting factor it is more convenient to get in contact with people on relevant positions within the companies through a telephone interview rather than a traditional face-to-face interview. This approach also gives the respondents more flexibility to choose when the interview is to be conducted and should

therefore minimize the risk that the respondents feel that they do not have time to conduct the interview. We have chosen to conduct the interviews during business hours and we also aim to have respondents to be situated in their offices rather than doing them on foot through their mobile phones. This decision was taken in order to create a natural environment for the respondents and to minimize the stress the respondents might feel. A disadvantage of not doing the interviews face-to-face is that we do not have the possibility to read the respondents reactions through body language, facial expressions and general behavior. The only soft factor we can observe through a telephone interview is their tone of voice, as well as their degree of hesitation before answering certain questions.

As we do not have the possibility to utilize a visual presentation of our material we have chosen to send visualizations and further explanations through e-mail prior to the interviews. This is done to enhance the respondents understanding of the research questions and to give them time to prepare relevant information and also to minimize the sources of error when conducting an interview via telephone. Finally, after the interviews were conducted, we sent the aggregated version of each interview, found in the empirics, to our respondents for a final fact-check. Important to note is that we only changed specific details, but did not allow the respondents to change the general information derived, as this would constitute a risk of the respondents trying to cover sensitive subjects valuable to our analysis.

#### 2.4.1.2 Interview question format

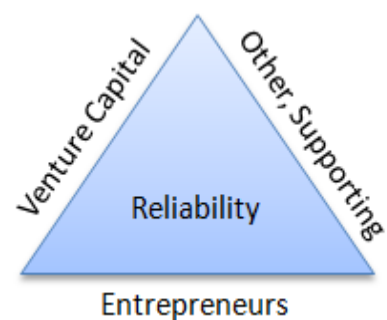
When choosing the format of the interviews we have chosen to get inspiration from Kylén's "funnel model" (Kylén, 1994, *translated*).



This implies that we initially asked broad and open questions in order to gain a broad understanding how the respondent regarded our research question and also their position relative to other stakeholders both within and outside their specific company. Following the questions of general character we continued by asking more specific questions regarding the respondent's opinions from their view point and concluded the interview with questions regarding specific cases and actions. We tried to use open questions in order to get as comprehensive answers as possible and we took great care not to ask leading questions. Due to the fact that we have utilized semi structured interviews, and as we have not been constrained by an extensive questionnaire, we have not been forced to modify the layout extensively of our interviews in order to get relevant answers.

#### **2.4.1.3 Respondents**

The respondents we have approached in our study were all chosen to provide insight regarding our purpose. In order to get an as holistic view of the information as possible, enabling us to conduct a more thorough analysis and to reach a better conclusion, we have chosen to approach both VC-firms and also entrepreneurs who have been involved in obtaining venture funding. The VC-firms we have contacted are all members of the Swedish private equity & venture capital association (SVCA) and should therefore be very knowledgeable within the field of study. As we expect the different VC-firms to have different views on the subject we have had a goal to interview as many as possible. However due to various factors, mostly related to insufficient time, many VC firms declined to be interviewed. We will elaborate on the effects of this further in the primary data criticism chapter (part 2.5.1). The answers we obtain from the VC-firms will then be benchmarked against the answers we obtain from the entrepreneurs and supporting respondents in order to get their perspective of the incorporation of IC in the due diligence process and also to give us more insight in the situation. This process, known as triangulation, used is further elaborated in chapter 2.6.





The initial contact to our respondents' workplaces was conducted via telephone which was later followed up through e-mail and further telephone conversations. In order to gain relevant information and to reach people that are informed on IC as a subject we have chosen not to aim for specific persons within the VC-firms, but instead rely on their recommendations on who to interview and to follow their redirections. This has put us in contact with people in various roles, including CEOs, CFOs, analysts and so forth. A potential negative effect of this approach is that the most fitting respondents are busy and we therefore interview a less suitable person. This effect is however nothing we have noticed and we feel that the general knowledge of our respondents was adequate.

#### **2.4.2 Secondary Data**

Secondary data implies data that has already been produced by someone else with another purpose than the objective at hand (Wiedersheim-Paul et al, 1997). As previously mentioned we cannot access the DD-framework used in practice by our respondents, therefore we have to use secondary data in order to gain understanding about how such a framework can be structured.

It is important that secondary data of high quality is chosen as the information is processed by the collecting instance (Bryman et al. 2005). In our case we have chosen data collected from various sources, including a generalized template for conducting a startup venture capital due diligence and also the EFFAS principles ([www.effas.net](http://www.effas.net), 2010), used to benchmark the method of IC reporting. Both these theoretical documents regarding business administration will be elaborated upon in the theoretical framework.

#### **2.5 Source Criticism**

When utilizing multiple sources of data, which we have done in this thesis, it is important to relate critically to these. We will divide our source criticism into two separate parts to facilitate the reader; primary data criticism and secondary data criticism. In the first part of these our purpose is to make the reader aware of that there is reason to remain critical to the information the respondents in our interviews have provided. In the second we present potential criticism to the documents we have utilized.

### 2.5.1 Primary Data Criticism

During the collection of the primary data we have interviewed numerous respondents regarding the subject of IC in the due diligence process of VCs. The method used is described earlier in the method chapter; however this part aims to evaluate the reliability and the neutrality of the sources. The respondents represent various titles in various firms; why there is a reason to believe that their individual responses are affected by factors unique to each respondent. It is however difficult to know if the answers they provide represent their own personal views or if they represent the views of the corporation or institution are they employed by. Furthermore, one should consider the interviewer-effects that can arise during semi-structured interviews. We had the intention to conduct the interviews in as similar pattern as possible, however due to the freedom we gave the respondents in their answers the interviews tended to take deviating paths. We were however very careful to take a neutral stance in the question whether IC is important or not. In order to be able to recall and analyze the interviews in a correct manner, we recorded all the conversations. This approach can however constitute a dilemma as the respondents might take a more defensive stance and not answer from their hearts in order not to be cited in a non-flattering manner. We tried to mitigate this effect by giving the respondents the choice of being recorded or not and that we will cite them with their consent.

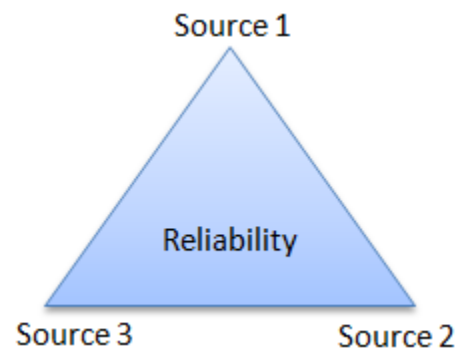
Lastly one factor that might affect the quality of our primary data is the difficulty to get respondents to agree to be interviewed at all. During our data collection we have tried to contact a large number of VC-firms, but only a few did actually want to participate in an interview. We believe that the reason for this is the relatively small sizes of the VC-firms and that they therefore cannot spare the time to respond to our questions and also that many firms claim that they are contacted by other researching students on a very frequent basis, why they have decided to decline all interview invitations. An effect of this might be that we only got in contact with people not actually involved in the due diligence process, but rather a more junior co-worker that could spare the time. However, we did not notice this effect during our interviews and feel confident that the respondents were quite knowledgeable about the subject.

## 2.5.2 Secondary Data Criticism

The secondary data collected are chosen from various sources and must be critically analyzed in order to establish whether they are dubious in any way. As both the DD-template and the EFFAS-principles were constructed by individuals there is always a factor of individual opinions of the authors. The EFFAS principles represent a federation's view, why we believe that this should be less affected by the previously mentioned factor. However, the DD-template was put forward by one individual in conjunction with the business interest of the authors own business, why this effect might be more serious. We do believe however, after a thorough analysis that the template still is of a general nature and can be utilized in this thesis.

## 2.6 Reliability

In order to achieve the highest level of reliability possible we have decided that the optimal tool to utilize in our case is triangulation, both regarding achievability and effectiveness. Triangulation implies that we will use a number of different data sources and theories when conducting a study of social phenomenon's (Bryman et al. 2005). In our research we will utilize interviews from various sources in order to strengthen the facts we present. The advantage of this method, besides providing confirmation of our results, is that we will be exposed to multiple approaches to the subject in question. A disadvantage might be that the sources are not synchronized, which will result in a situation where we as researchers will have to rely on our own values, which can negatively affect the reliability. If the sources provide conflicting information we will disclose this in order to give the reader insight in our assessments of the different sources.



## 2.7 Transmittability

Throughout the thesis we have followed the general guidelines regarding transmittability in relation to qualitative interviews. This implies that we have focused on a rather small number of respondents and secondary sources in order to achieve as much insight within these as possible, contrary to analyzing a too broad amount of data. Our goal is to achieve "thick descriptions",

meaning a comprehensive explanation regarding intellectual capital and venture capital which can be utilized to transfer our findings to another scenario, allowing for future research (Geertz, 1973).

## 2.8 Dependability

Our intention is to conduct a study with a high level of dependability, where the reader feels that the results presented is trustworthy. In order to create a high level of dependability we will present our process extensively and disclose all phases in our research process. Our hope is that the conclusions we present will gain a high level of dependability due to this extensive disclosure of our process.

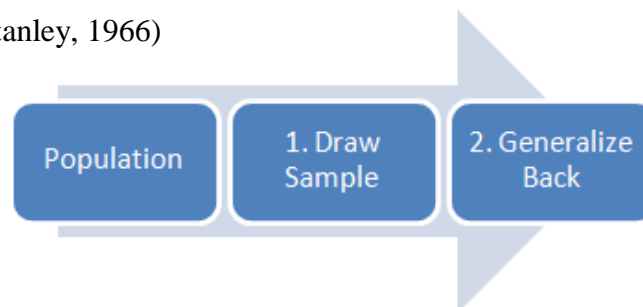
## 2.9 Validity

Validity can be of both external and internal nature. As internal validity, the establishing of cause and effect, is mostly used when conducting a quantitative study (Campbell et al, 1966), which is not the case in this thesis, we will instead focus on achieving a high degree of external validity.

### 2.9.1 External Validity

*“External validity asks the question of generalizability: To what populations, settings, treatment variables and measurement variables can this effect be generalized?”*

(Campbell & Stanley, 1966)



As we are limited by time and resources there is no way for us to interview all existing VC-firms on the market. What we then aim to achieve is that the respondents we choose are to be able to be generalized in order to represent a wider population in the real world (Trochim, 2006). In order to achieve external validity we have chosen to utilize the sampling model, where we try to approach respondents that are able to represent the rest of population we aim to generalize to. The problem with this approach is the previously mentioned difficulty of getting in touch with the appropriate

respondents, and therefore the validity might be negatively affected. However, through persistence, we were able to interview 6 VC firms, which in terms of the relatively small VC-industry on the Swedish market should be able to represent the other VC to a satisfactory level. In conjunction to the VC firms we interviewed, we also interviewed business angels and entrepreneurs in order to further increase the ability to generalize the results we found. Based on our approach and the rather similar inputs we got from the various sources, we feel that we have been able to achieve a high level of external validity.

## 3 Theoretical Framework

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*In this chapter we will present the theories which will later be used in order to conduct our analysis. Initially we present why these theories were chosen, and following this we present the theories to the extent needed in order to analyze the situation in coherence with the purpose of this thesis.*

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### 3.1 Choosing Theories

The theories presented below are the theoretical foundation upon which we will conduct our analysis in order to reach our purpose. Our purpose relies on three main pillars of theories, which are intellectual capital, due diligence and venture capital. Initially we will therefore explain the theory of intellectual capital more thoroughly and from here continue to explain the concept of due diligence. To provide the context we will also describe the theories of venture capital. As a key concept within IC is knowledge, we will provide information regarding knowledge theory. Lastly, the 10 EFFAS principles are elaborated upon, as they will provide the benchmark upon which we will base our analysis and conclusion.

### 3.2 Intellectual Capital

Defining a standardized explanation of IC has been a topic of constant discussion among scholars during many years and many such definitions has been proposed (Edvinsson et al. 1997). IC has been appreciated long before the term itself was coined in form of the common sense to acknowledge skill and such, however it is only during the recent past when this has been empirically measured and put into more concrete value adding factors within IC (ibid). There is a certain consensus regarding the general meaning of the term in that it touches upon the lacking of competence among “traditional” accountants to capture a company’s true value, illustrated by the fact that the majority of companies on the world’s stock exchanges are valued far above their reported book value of assets. Charles Handy of London Business School has estimated that these IC assets may typically be worth three or four times a company’s tangible book value and according to Morgan Stanley’s World Index, the average value of companies on the world’s stock exchanges is two times book value (Edvinsson et al. 1997). The explanation of this difference in value is attributed to IC. It is therefore clear that IC is a very important factor in capturing a

company's true value and therefore a standardized explanation of the term has become a necessity.



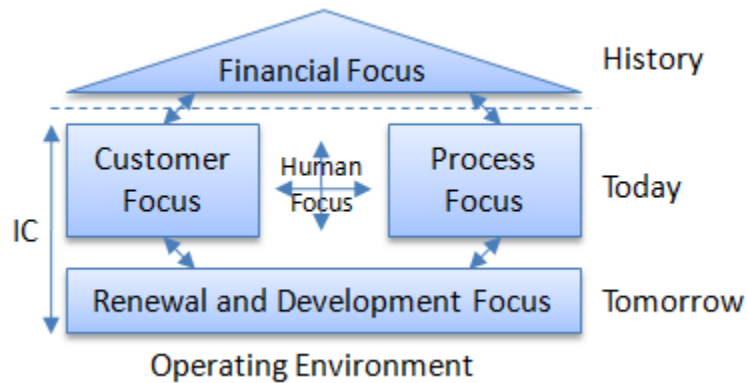
To best understand the role of IC one can utilize an illustration put forward by Edvinsson et al, the organization as a tree, where half the mass is the non visible root system below ground level and the stem, branches and leafs is an indication of the health of the tree at the present moment. However, in order to understand the potential health of the company in the future, one must study the roots, or the IC that is the foundation of the future value, why the tree then is turned upside down (above). What factors are then included in this essential concept? Edvinsson et al divide the factors into two general forms: Human and Structural Capital, where:

$$\textit{Human Capital} \times \textit{Structural Capital} = \textit{Intellectual Capital}$$

Human capital constitutes “the combined knowledge, skill, innovativeness, and ability of the company’s individual employees to meet the task at hand. It also includes the company’s values, culture, and philosophy.” Structural capital complement human capital as it is “the hardware, software, databases, organizational structure, patents, trademarks and everything else of organizational capability that support those employees’ productivity. [...] Structural capital also includes customer capital, the relationships developed with key customers. Unlike human capital, structural capital can be owned and thereby traded.” (Edvinsson et al. 1997).

Regarding VC-firms, where the investment opportunities often have low or non-existing book-values, IC naturally becomes very important. We see two factors within IC that crystallize especially; the fact that IC focuses on different factors than tangible assets and that IC takes the

present and the future situation into account, contrary to traditional accounting which report historical numbers, illustrated by the Skandia Navigator:



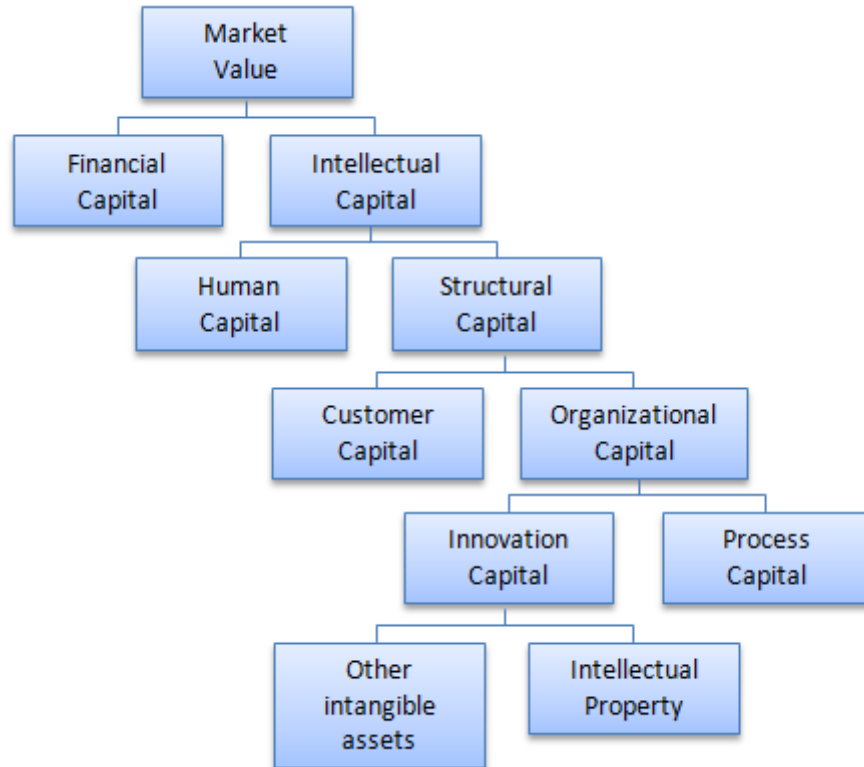
The fact that IC focuses on the present and future value can also be attributed to the tree metaphor previously mentioned, it is the health of the roots today that will determine the company's ability to create value in the future. A company can look prosperous today, but if the roots, or the IC, is not nourished then the future have a high probability to be grim. It is therefore important for firms and analysts alike to shift focus from the historical financial factors and instead focus on the future values created by human and structural capital in order to identify future growth opportunities and pitfalls (Edvinsson et al. 1997).

To elaborate further on the two fundamental building blocks of IC, human and structural capital, one can utilize the Intellectual Capital Value Scheme:

### 3.2.1 Intellectual Capital Value Scheme

According to this model, the human capital is a factor in itself; however the structural capital is comprised of a number of different factors which are all interrelated.





Important to note in this model is that the market value of a firm is comprised of financial and intellectual capital. The financial capital in this case is rather straight forward and something which naturally is carefully considered when evaluating new ventures. Our purpose is to evaluate the consideration of the IC-part of this scheme, which in turn is comprised of many factors each being affected by different inputs. As human and structural capital is explained in chapter 3.1, we will here elaborate more on the unexplained factors.

*Customer Capital* – initially this form of capital was included in the structural capital but has later been broken out as a separate category. This suggests that the relationship of a company to its customers is distinct from that of its dealings with employees and strategic partners, and that this relationship is of absolutely central importance to the company’s worth. One can look at customer capital as the strong and loyal customer base consisting of the difference between the value of what the company sells and the value of the patents and copyrights it holds (Edvinsson et al. 1997).

*Organizational Capital* – “Is the company’s investments in systems, tools and operating philosophy that speeds the flow of knowledge distribution channels. It is the systemized,

packaged and codified competence of the organization as well as the systems for leveraging that capability” (Edvinsson et al. 1997). Organizational capital is in turn comprised of innovation and process capital.

*Process Capital* – is those work processes, techniques and employee programs that augment and enhance the efficiency of manufacturing or the delivery of services, or the practical knowledge used to create continuous value (ibid).

*Innovation Capital* – refers to the renewal capabilities and the results of the innovation in the form of protected commercial rights, intellectual property and such, used to create and rapidly bring to market new products and services. Innovation capital is comprised of *intellectual properties*, such as trademarks, and *intangible assets*, such as the theory by which the business is run (ibid).

### **3.2.2 The importance of reporting and measuring IC**

Given the general importance of IC described above is it also very important to understand how to report and measure IC, as according to Edvinsson et al “An economy that cannot properly measure its value cannot accurately distribute its resources nor properly reward its citizens” (Edvinsson et al. 1997). This is especially important for young and innovative firms who due to inaccurate measurement can suffer insufficient funding and in the worst case thereby be unable to pursue their mission (ibid).

It should therefore be in the interest of all stakeholders, from the firms trying to obtain funding, the VC firms to the politicians and the government to achieve a more accurate reporting and measurement of IC in order to more efficiently allocate resources to the investment opportunities holding the highest degree of potential returns (ibid).

### **3.3 Due Diligence**

The term due diligence originates from the Securities Act of 1933 and refers to the adequate investigation of companies whose equity was for sale. If such “due diligence” was done, then the broker-dealers could not be held liable for nondisclosure of information that was not discovered

in the process of that investigation (Wikipedia.com, 2010). Interesting is then the fact that one of the most important corporate values, IC, is not a mandatory subject in such a process.

A due diligence can be performed by both a buyer and a seller of a corporation and has the purpose reduce the information asymmetry by ensuring that the target is able to live up to the buyer's expectations and to provide a form of insurance and guarantee against adverse surprises (Kersby, 1998). Furthermore it is the purpose of due diligence to inform the concerned parties of the value of the corporation in order to avoid mispricing and to reduce the risk for potential legal conflicts (Howson, 2006). Hence due diligence is used to verify the initial analysis and valuation that the buyer previously has performed.

In most cases the requirement for a due diligence is attributable to the buyers as they are in a position where they have an informational disadvantage. The most usual process is that the data needed is provided to consultants which perform the due diligence. It is possible for the buyer to perform the process themselves, but this requires them to have extensive knowledge and competence which the complex due diligence-process requires (Johansson et al 2002).

It is important that the consultants receive adequate relevant information as this identifies potential synergies and future profits and therefore constitutes the foundation upon which the buyer uses to decide whether to proceed with the acquisition negotiations (Sevenius, 2003).

### **3.3.1 Different forms of Due Diligence**

There are various main topics a due diligence can cover, depending on the subject to be reviewed. A complete due diligence is therefore often divided into a number of parts which then constitutes the sum. The most important such parts are financial, commercial and legal due diligence (Sevenius, 2003). However several scholars has proposed to include other types of due diligence as well, and these are tax, labor, technical, cultural and environmental due diligence (Orrbeck, 2006; Isaksson et al. 2002). These steps are not performed in a specific order, but are rather performed interchangeably and it is common that various experts on different subjects cooperate.

### **3.3.2 Performing the due diligence – the template**

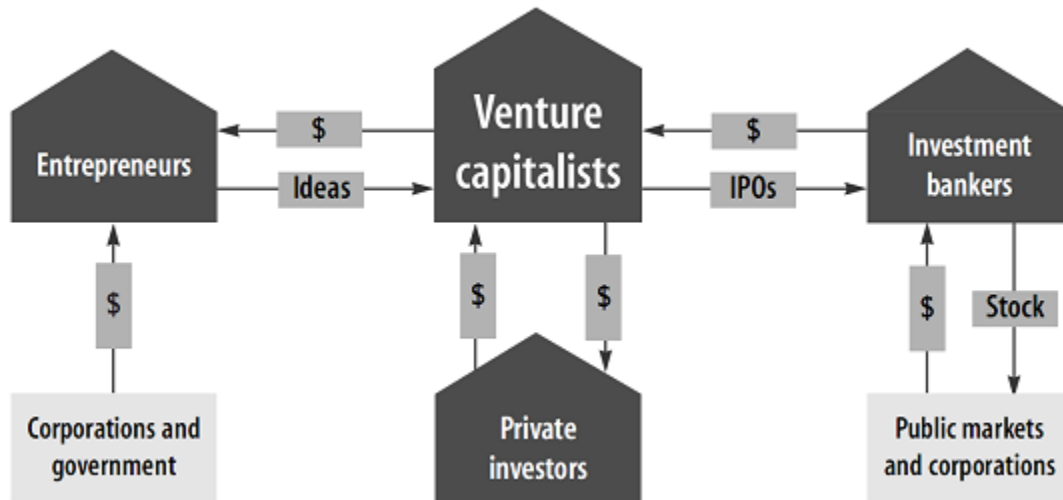
How to perform the actual due diligence is case specific and which parts of the due diligence discussed above are most important therefore differs. Factors deciding which areas should be in focus are; type of target corporation, involved individuals, time frame, the complexity of the target, risk profile and the budget set aside for the due diligence (Isaksson et al, 2002). As the purpose of this report is to examine the effects regarding venture capital investments, Corey Pierce (2007) has proposed a template on how this due diligence should be performed, shown in appendix 1. When utilizing this template, it is important to keep the deciding factors above in mind.

The template in appendix 1 shows the extensive amount of information a firm needs to disclose in order for the VC to even consider investing. Providing information regarding the 14 categories and their numerous sub categories is time consuming and costly for new ventures which often have only a few employees. It should therefore be in the interest of the startups to disclose all value adding factors, in order to maximize the potential for funding.

## **3.4 Venture Capital**

### **3.4.1 Introduction**

Venture capital is money provided by an outside investor to finance a new, growing or troubled business. This capital is not invested like a loan, but for an equity stake in the company and the investor hope that the investment will yield a return above average. The venture capitalist provides the money knowing that there is a significant risk in the investment and therefore has quite high expectations on the yield of the investment. The venture capitalist therefore typically looks for new and small companies that have a high growth potential that can yield the wanted return. The high risk of the investments shows in the success rate: anywhere from 20 percent to 90 percent of the portfolio companies of a VC may fail to return on the VC's investment. On the other hand, if a VC does well with its investment, its portfolio can offer returns of 300 to 1,000 percent. Given the rigorous expectation on the return of investment, the most typical companies to obtain venture capital are rapidly expanding companies in industries such as ICT (information and communication technology), biotechnology and life science (Pearce & Barnes, 2006).



Source: Zider 1998

A venture capitalist does not necessarily make his investment on his own. Most VCs partner up with other VCs to form a fund of pooled investment capital with which to invest in a number of companies. This is a way of reducing the risk for a VC since each investment carries quite high risk. Many VCs are affiliates or subsidiaries to large commercial banks, investment banks or insurance companies that make investments on behalf of clients of the parent company (Pearce & Barnes, 2006). This is the relation that is depicted between the “Private investors” and “Venture capitalists” in the figure above (Zider, 1998).

Venture capital is an important source of funding for start-ups and other companies with no or limited history and thus have a hard time achieving capital from banks and other actors on the financial markets (Pearce & Barnes, 2006). As can be seen in figure above, Venture capitalists fill this gap in the financial markets as they become an intermediary between the entrepreneurs and the investment bankers and public markets (Zider, 1998).

Vcs aim to use its business knowledge, experience and expertise to nurture the companies they invest in and to help them develop successfully and then exit the investment normally within three to seven years. Therefore, in addition to the portion of equity the VC gets, the VC expects to have a say in how its portfolio companies operate. Ideally, the VC fosters growth at the company through its involvement in managerial, strategic and planning decisions. Some VCs are generalists that invest in a variety of industries and locations, but since a lot of expertise is

needed from the VC to make the investment successful it is more typical that the VC is specialized in a certain industry. Many VCs also have a geographic preference (Pearce & Barnes, 2006).

### **3.4.2 Types of funding**

There are five types of funding that a VC can offer: seed capital, startup capital, early stage capital, expansion capital and late stage capital. A VC can be specialized in any of these types of funding, or it can provide funding for all stages of the business cycle. It is important for a company to know the preferences of a VC, and to clearly articulate what type of capital it is seeking when approaching a VC (Pearce & Barnes, 2006).

Seed capital is aimed at entrepreneurs that have recently started their company and have no product or organized company yet. Not many VCs invest in this stage and the size of the investment is likely to be small. Invested capital will probably be used to create a sample product or fund market research. Startup capital is for companies that have a sample product available and at least one principal working full time with the company. Funding at this stage is also quite rare and the capital is most often needed to cover such things as recruitment of other key management, additional market research or introducing the product on the market. Early stage capital is for a company that has its business running and has had it so for a couple of years. VC capital could in this phase provide the company with the extra financials needed to increase efficiency and productivity in order to increase sales and reach the break-even point. Expansion capital is for well established companies that are looking to reach the next level of growth by collaborating with a VC and late stage capital is for a company that has already reached impressive sales and that might be interested in increasing capacity and marketing further (Pearce & Barnes, 2006).

### **3.4.3 What do VCs look for?**

As mentioned many times before in this text, VCs look for companies that have a high growth potential so that they can get an attractive return. This means that they are not just interested in startups, and that the current size of your business means less than the prospects for future growth. VCs are looking for companies that have the potential of becoming a large market leader in its industry due to some new industry opportunity and competitive advantage. There is no

single determinant of a successful portfolio company but a VC tends to focus on the following factors: commercially viable, identifiable market, strong management and sustainable competitive advantage (Pearce & Barnes, 2006). The commercially viable factor is that the VC evaluates whether the company has a product or a service that can be produced efficiently to generate revenue. When trying to identify if there is a market for this product or service the VC evaluates if the product/service corresponds to any unfulfilled need in the market. The perceived knowledge and skills of the management team is also very important for the VC. Last but not least, the VC evaluates whether the company has a sustainable competitive advantage that cannot be duplicated easily by competitors. A VC will also look at measures that a banker would look at, such as historic results, amount needed, intended use of amounts and future projections. But since a VC is a part owner, the VC will look more for long term capital, and factors determining the ability to create long term capital, rather than looking at factors determining the ability to pay interest (ibid).

#### **3.4.4 Valuation methodologies**

There are a number of ways in which a VC can value a company. In order to reach some consensus and transparency in the area, the IPEV (International Private Equity Valuation) board has together with many national private equity and venture capital associations developed the International Private Equity and Venture Capital Valuation Guidelines. These guidelines set out recommendations that are intended to represent current best practice on the valuation of private equity and venture capital investments. The guidelines state that the value that one tries to reach when valuing a company is the fair value of the company. The fair value is “the price at which an orderly transaction would take place between Market Participants at the Reporting Date”. For quoted instruments, the fair value would be the market price, but for unquoted investments the estimation of fair value requires the value to assume that the underlying business is realized at the reporting date. In estimating the fair value, the value should “apply a methodology that is appropriate in light of the nature, facts and circumstances of the investment, and its materiality in the context of the total investment portfolio and should use reasonable data and market inputs, assumptions and estimates” (International PE and VC Valuation Guidelines, 2009).

The guidelines put forward a number of valuation methodologies that VCs can use, including:

- 1) price of recent investment
- 2) multiples
- 3) net assets
- 4) discounted cash flows or earnings (of underlying business)
- 5) discounted cash flows (from the investment)
- 6) industry valuation benchmarks

Valuing a company on the basis of price of recent investment can be a useful method when the investment being valued was itself made recently. The cost may then provide a good indication of fair value. Also, when there has recently been an investment in the company being valued, the price of that investment will provide a basis for the valuation. The drawback of valuing a company in this way is obviously that its validity is eroded over time, since the price of a previous investment reflects the conditions that were present at the time of investment. In an environment with ever changing conditions, the passage of time will lead to uncertainty regarding this method and thus reducing its validity. The length of period for which it would remain appropriate to use this methodology will depend on the specific circumstances of the investment and is subject to the judgment of the value. In the case of seed companies or start-ups, the guidelines state that due to the frequency with which funding rounds are often undertaken for seed and start-up situations, this methodology will often be appropriate for valuing investments in such situations. Another reason for why this methodology can be useful on seed companies and start-ups is that these companies normally do not have any current or short-term future earnings or cash flows (International PE and VC Valuation Guidelines, 2009).

Using multiples to value an investment opportunity involves the application of an earnings multiple to the earnings of the business being valued, in order to derive a value for the business. This method is likely to be useful for an established business with an identifiable earnings stream that is likely to be stable in the future. For valuing a company that is in its early stages, using a revenue multiple might be more appropriate. This method may be useful if a company has negative earnings that are believed to be of a temporary nature and it is possible to identify a normalized level on the earnings of the company (International PE and VC Valuation Guidelines, 2009).



The methodology of net assets involves deriving the value of a business by reference to the value of its net assets. This methodology is appropriate for businesses whose values are determined more by the value of its underlying assets than its stream of cash flow, such as real estate companies, other property holding companies and investment businesses. This method may also be useful for a business that is not yielding an appropriate return on its assets and it would thus be more valuable to liquidate the business and sell its assets (International PE and VC Valuation Guidelines, 2009).

Discounted cash flow (DCF) is the method of calculating the present value of expected future cash flows in order to derive a value for the company. The DCF technique is a flexible method since it can be applied to any stream of cash flows. This means that it can be applied in many situations where other methods of valuing a company are inadequate. The disadvantages of the DCF technique is that it totally depends on the cash flow forecast, the terminal value and the discount rate, and thus that the accuracy of these three factors become very important. Making accurate projections of these three parts is very hard and this method thus becomes quite subjective and sensitive to any changes in any of these three input factors. According to the guidelines, since the level of subjectivity is so high in selecting the inputs to this technique, DCF valuations are useful as a benchmark to values estimated by market based methodologies and should be used only in isolation of other methodologies under extreme caution. Also due to the subjectivity of inputs, in assessing the appropriateness of the method, the value should consider whether the disadvantages of the method are such that it is not valid to say that it has rendered a Fair Value in a reliable way (International PE and VC Valuation Guidelines, 2009).

Some industries have industry-specific valuation benchmarks, such as “price per subscriber” for cable television companies. Other industries where long-term contracts are a key feature use multiples of revenues as a valuation benchmark. These industry valuation benchmarks are often based on the assumption that investors are willing to pay for turnover or market share. The guidelines state that “the use of such industry benchmarks is only likely to be reliable and therefore appropriate as the main basis of estimating Fair Value in limited situations, and is more likely to be useful as a sense-check of values produced using other methodologies (International PE and VC Valuation Guidelines, 2009).

### 3.5 Knowledge Theory

*“Information is that commodity capable of yielding knowledge, and what information a signal carries is what we can learn from it (Dretske, 1981). Knowledge is identified with information-produced (or sustained) belief, but the information a person receives is relative to what he or she already knows about the possibilities at the source” (ibid).*

The above citation is a definition of information and knowledge, terms that often are used interchangeably, but between which there is a clear distinction. Knowledge can be divided into two dimensions, tacit and explicit knowledge. Explicit knowledge is rather simple to grasp, it is the digital, or discrete, knowledge captured in libraries, databases and such. It can be accessed on in a straight forward manner and can be assessed on a sequential basis (Nonaka, 1994). Tacit knowledge however is a more elusive term. Michael Polanyi (1966) states that “we can know what we can tell” and that the knowledge expressed in words and numbers only represents the tip of the iceberg of the entire body of possible knowledge. Tacit knowledge is deeply rooted in action, commitment and involvement in a specific context. It can in turn be divided into two subcategories, or elements, as well; cognitive and technical elements (Nonaka, 1994). The cognitive elements center on so called “mental models” in which human beings form working models of the world by creating and manipulating analogies in their minds, which provide perspectives that help individuals to perceive and define their world. The technical element of tacit knowledge however is more focused on concrete know-how and skills that apply to different contexts (Nonaka, 1994). Tacit knowledge is a continuous activity of knowing and embodies an “analogue” quality, meaning that the communication between individuals may be seen as an analogue process that aims to share tacit knowledge to build mutual understanding.

Direct examples of tacit knowledge are best practices, experience, wisdom and non recordable intellectual property that live within individuals and teams. As the tacit knowledge exist only in the human mind, it cannot be manipulated or recorded directly, but it is however of critical value to any organization and in a early venture it can embody the vision and mission of the corporation, as well as core competencies (Nonaka & Takeuchi 1995).

### 3.5.1 Acquiring Knowledge

Taking the information learned in section 3.5 we must further break this down in order to understand the underlying problem which is the ability to estimate and value the knowledge of a knowledge firm in order to put a correct price on the startup. The question is then how to price knowledge and what knowledge the VC needs in order to do this estimation. The first difficulty a VC encounters is the difficulty to observe asset quality, due to the inability to observe this factor in the financial statements and the uncertainty of the tacitness (Coff, 1999). This results in a situation of information asymmetry where niched VCs probably have a greater ability to assess the value of the targets knowledge as they already are knowledgeable regarding the industry (ibid).

As Coff (1999) states, markets in general have much less information about the quality of a firm's knowledge base than its physical capital. This is especially true for a start up where the financial statements in most cases hold little or no physical assets, which is especially true for knowledge firms. It is therefore imperative to be able to evaluate the quality of the knowledge, or the IC, of the startup in which they intend to invest.

### 3.5.2 The knowledge firm

Important to our purpose is to understand the concept of the knowledge firm, since it is these kind of firms in which IC has the most obvious application. One can differ between manufacturing firms and knowledge firms in such a way that the knowledge firm utilizes knowledge as a source in order to achieve competitive advantage (Edvinsson & Sullivan, 1996). The competitive advantage can be achieved in various ways, however it is most frequently observed in value adding industries, both in the product and the service field. In the product field we find firms such as the computer software developers, biotech firms and such. In the service field we find law firms, consulting firms, media companies, et cetera - all utilizing knowledge within the human capital as the key for success (ibid). Even though the knowledge is present within the human capital it is important to note that perhaps the most valuable asset for a knowledge firm is the structural capital as this provides them with a tool to leverage the knowledge and also a structure for maintaining the complementary business assets necessary for maximizing profit. The

structural capital is present within all firms and can be found in the tangible balance sheet items (ibid).

### **3.5.3 Knowledge Management**

Connecting the theories of knowledge above to the management of IC is the knowledge management (henceforth KM). According to the definition of Imperial Knowledge of London the definition of knowledge management is “The process of capturing, organizing, and storing information and experiences of workers and groups within an organization and making it available to others. By collecting those artifacts in a central or distributed electronic environment (often in a database called a knowledge base), KM aims to help a company gain competitive advantage. (<http://www.imperial.ac.uk>, 2010). Similar to IC management the overall purpose of KM is to maximize the enterprise’s knowledge-related effectiveness and returns from its knowledge assets and to renew them constantly (Wiig, 1997). This further rigidifies the notion that IC is one of the most important resources an enterprise owns and that the knowledge needs to be carefully appreciated when evaluating its future potential.

### **3.6 The 10 EFFAS Principles for Intellectual Capital**

The European Federation of Financial Analysts Societies, or EFFAS, has constructed a general guideline for the reporting and appreciation of IC for an individual company ([www.effas.net](http://www.effas.net), 2010). Following these guidelines, and thereby successfully reporting IC, will according to EFFAS benefit companies in two ways. Firstly they can improve their internal operations by more effectively managing their internal investments and resource allocation, as they increase internal transparency and provides a better understanding on which investments in IC will provide the highest returns. Also, a stronger emphasis on IC will improve the possibility of identifying future growth opportunities (EFFAS, 2008). The second way is to improve their external relations by better communicating true strengths to various stakeholders, and thereby being able to stand out from the crowd (ibid).

Important to note is that these principles states *how* to report IC rather than *what* to report. We will therefore use these principles in conjunction with the IC value scheme above in order to be

able to provide a more holistic contribution on how and what should be reported in the due diligence process, regarding IC.

Below is a list of the principles to be followed by EFFAS (2008), along with a short description of the purpose of each principle.

- I. *Clear link to future value creation* – The indicators should be able to provide grounds for decisions for investors. The indicators should therefore provide a clear link to future value creation
- II. *Transparency of methodology* – An explanation of how the principles disclosed are derived. It is important to ensure that the value of the indicators exceeds the cost of obtaining the information.
- III. *Standardization* – A standardized approach to reporting IC allows for a more effective discussion and comparison of the company’s potential performance. EFFAS strives to achieve a “market best practice” in the future. In other words, only standardized intangibles indicators can be benchmarked between companies and only benchmarked indicators are truly useful.
- IV. *Consistency over time* – A principle to further allow for benchmarking, but this is over time. If the set of indicators is altered, a clear explanation of this should be put forward.
- V. *Balanced trade-off between disclosure and privacy* – This principle is to prevent disclosure of IC which can result in competitive disadvantages. It is important to find the right balance between the disclosure of IC and the privacy needed.
- VI. *Alignment of interests between company and investors* – An alignment of the information the individual company is asked to provide and the information needed by analysts in their valuation framework.
- VII. *Prevention of information overflow* – As the information available at the market at present already is extensive it is important to disclose only relevant IC-factors in order add value to investors.
- VIII. *Reliability and responsibility* – As with any corporate information it is important that the IC reported is reliable and attributable to the “true” situation of the firm. The

disclosure should also be objective and verifiable. One can connect this to the transparency principle.

- IX. *Risk Assessment* – When possible, all reported indicators should be accompanied by an assessment of their inherent risks, for example in human capital in key personnel leaving the corporation.
- X. *Effective disclosure placement and timing* – the information should be disclosed through efficient and effective channels and with adequate frequency. EFFAS suggest the frequency should coincide with the annual report, either through a management commentary in the report or through a separate IC-report.

## 4 Empirics

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*In chapter 4 we will present our findings during our data collection, which is later to be analyzed. This data involves interviews with venture capital firms, entrepreneurs and business angels. The data is summarized by category and respondent. Note that the interviews were held in Swedish and the presentations therefore are translated by the authors of this thesis.*

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### 4.1 Venture Capital Firms

#### 4.1.1 Jonas Hansson, HealthCap

HealthCap is an international venture capital firm investing money from pension funds, private equity firms, banks and universities from various countries. The money has over the years been structured in different funds and HealthCap is today investing money from their fifth fund called HealthCap V that was established in the spring of 2006. HealthCap V is currently actively pursuing new investment opportunities. HealthCap invest globally in pharmaceutical, biotechnology and medical technology companies. Investments are made in the early stages of the business cycle as well as in more mature companies.

The HealthCap office in Stockholm is responsible for all investments in Europe and when a possible investment is discovered, it is proposed to their general partner in Switzerland, who then takes the investment decision. Half of the partners have a background within banking and thus have transaction expertise, and the other half are doctors with knowledge of the product developments of possible investments.

Jonas Hansson is working as an associate at the Stockholm office. He is, together with three or four others, looking at investment proposals in the first stage and decide which investment opportunities to perform a due diligence on.

##### *4.1.1.1 Present Due Diligence Model*

Before performing a due diligence, HealthCap evaluates whether the company has the potential to be a success by looking at different factors such as if the products will fill a need in the market, if the products have been tested with positive results and if the company has strong intellectual property (patents).

The team performing the due diligence is comprised by one partner with expertise from making transactions and one partner with expertise from the medical area, plus one associate such as Mr. Hansson. If there is a need for it, the rest of the bureau will also help but the basic set up are these three persons.

HealthCap use consultants to perform the due diligence of the legal aspects as well as evaluating the intellectual property. Before hiring consultants to do this, HealthCap themselves perform a commercial due diligence on the company.

#### *4.1.1.2 IC opinion*

Mr. Hansson says that in order for HealthCap to invest in a company, they have to believe in the abilities of the management. This is extremely important, according to Mr. Hansson since it is much more likely that the project has good prospects but that management does not have the ability to run it than the other way around. The only way HealthCap could invest in a company without believing in the management is if they believe that they can replace management. Since HealthCap believe that human capital is so important they always take a seat on the board themselves to further boost the human capital of the firm.

HealthCap use discounted cash flow and peer valuation when valuing the investment opportunities they face. The human capital of the firm can not change the valuation of the firm. Mr. Hansson says that either the management is OK and then making the investment can be taken into consideration, or the management does not reach the requirements and then there will be no investment. Other parts of the IC can affect the valuation though, such as intellectual property (patents in HealthCap's case). If there is no intellectual property there will be no investment, but if the intellectual property is well protected then the valuation can be altered.

If the investment company is supposed to sell the product on the market, it is important to have a relationship with the end customer. If the investment company is supposed to sell its product to a Big Pharma company, the relationship to that company is of course very important. Valuable processes in the investment company are not very important to HealthCap as they invest in such an early stage. It is important though that the company has a plan for how these processes will be developed as the company go through the business life cycle.



Almost all of what HealthCap evaluate is included in the definition we have of IC. The part that is not included is the market analysis, which is an analysis that HealthCap perform before they look at customer capital and process capital.

#### **4.1.2 Staffan Helgesson, Creandum AB**

Creandum is a Venture Capital firm run by former entrepreneurs. They are an independent and partner owned firm that invests in Nordic companies in the technology sector, and currently they have approximately 120 million Euros under management. Creandum has an investment span ranging from the smallest investments of a couple of hundred thousand Euros up to 10 million Euros over the life cycle of a company. Creandum say that they know what it is like to be an entrepreneur and that they therefore know about the challenges that entrepreneurs face. Creandum further state that they have a passion for early stage technology firms and that they have significant experience from taking technology firms global (creandum.com).

Staffan Helgesson is one of the partners at Creandum and he has extensive experience from the venture industry and how to create a successful corporation.

##### **4.1.2.1 Present Due Diligence Model**

Creandum are doing their due diligence on their own and in collaboration with external actors. The legal due diligence is always done by external actors, the financial due diligence is also done by consultants and the technological due diligence is from time to time done by consultants. The due diligence on the market and the company's position on the market are rarely done by consultants. What Creandum focuses on is the commercial due diligence: interviews with customers, analysis of the market, competition etc. Creandum are also conducting the assessment of the entrepreneur themselves. The reason for this, according to Mr. Helgesson, is that the business knowledge and the knowledge of assessing personal skills are identified as core competencies, and a company cannot outsource core competencies.

##### **4.1.2.2 IC opinion**

*“We think that it [IC] is super important” – Staffan Helgesson, Creandum*

Mr. Helgesson states that the knowledge of assessing the personal skills of an entrepreneur or a management team is the most important skill to have for a venture capitalist when valuing a company. He further states that when Creandum value a company, the three most important factors they look for in the investment companies are: the individuals in the company, the market, and product offer or business model. Among these are the individuals in the company the most important factor, especially the earlier a company is in its life cycle. Regarding patents and such, Mr. Helgesson says that they do not value that as much as other probably do. Patents can be valuable and it can give you a head start to competitors, Mr. Helgesson further says, but he once again stresses that what you need to have to start a successful business is the right individuals in the right market with the right offer. And if any of these had to be chosen as the absolute most important it would be the individuals behind the company, since nothing turn out as planned when a business is created.

When answering the question on what factors Creandum look at when evaluating the individuals Mr. Helgesson say that they do not follow a standardized approach, but that they use a principle called “have done, will do”. That is that they try to isolate skills such as analytical thinking and leadership and try to see when the individual has shown signs of these skills in the past. If the management team does not meet the criteria Creandum have, they will not make the investment. However, if the management team is regarded to have exceptional skills, Creandum can pay a premium for this. The importance of the individual behind the company is increasing all the time, and has been doing so historically as well, according to Mr. Helgesson.

Mr. Helgesson further thinks that a framework for capitalizing IC in a more structured way would not hurt, but it would at the same time not make that much of a difference for how Creandum work, since Creandum is such a small company. A larger company with offices all over the world has a need to standardize the IC evaluation in a totally different way.

In the concluding remarks, Mr. Helgesson underlines how important Creandum think that IC is. He says that their definition of IC is a bit different than the one we are using in this thesis since they mainly think of human capital, and that the evaluation of structural capital is organized under the commercial due diligence when looking at the company, its business model and

product. The fact that they have divided it in this way is does not matter very much according to Mr. Helgesson, since they cover all parts anyway.

When speaking about IC generally, Mr. Helgesson say that Creandum are surprised that there is not more debate about this in media. He says that there is a lot of debate about why Swedish research does not deliver more results, but that it is not acknowledged that it is talented individuals that are the key resources, not the ideas and research itself.

#### **4.1.3 David Sonnek, SEB Venture Capital**

*“The target should have the possibility to become three times as valuable within 4-5 years.”* – David Sonnek, SEB Venture Capital

SEB Venture Capital is the venture capital arm of Skandinaviska Enskilda Banken. They focus on companies with high growth potential and specialize within the Technology and Health Care Sectors. Their investment size can be up to MSEK 100 ([www.seb.se](http://www.seb.se), 2010) and with this capital they invest both in startups and provide expansion capital. When conducting an investment they become active minority owners, represented on the board of directors. The representative from SEB VC we spoke to was David Sonnek, the Head of Technology Investments. He has been active within SEB VC during the last 10 years.

##### **4.1.3.1 Present Due Diligence Model**

As SEB VC frequently is approached by a large number of entrepreneurs with potential investment opportunities, they do not have the resources to conduct a due diligence for all these proposals. Mr. Sonnek explains that the due diligence is performed when the likelihood of an investment already is high, and that they then use legal and financial expertise to evaluate the company and all of its assets, including intellectual property such as patents. Interesting to note is that they also utilize HR-expertise to evaluate the management team. The actual decision whether it is a profitable opportunity and if they are to invest, is a decision they take themselves. Furthermore they see to that the SEB VC representative will take a seat on the board and lead the company towards an exit. Mr. Sonnek does not however rule out the possibility to hire a strategy consultant when it comes to exceptionally large investments and industries in which they are not as knowledgeable.

When evaluating an investment opportunity, Mr. Sonnek names a number of factors they take into consideration, such as the market potential, competition, the management team and so forth.

#### **4.1.3.2 IC opinion**

*“[The consideration of IC] is natural to us. This perspective is impossible to neglect, as this constitutes the majority of the value in a startup”* – David Sonnek, SEB VC

Prior to stating the respondent’s opinion regarding IC it is important to evaluate their insight in the subject. In the case of SEB VC and David Sonnek, he is very knowledgeable and has discussed the subject with the leading researcher in the field, Leif Edvinsson. Mr. Sonnek claims that he appreciates the factor, but does not quantify it as a balance sheet asset and does not use the term as a rubric in an investment memorandum. He does however consider IC to be the actual asset in which they invest, as there are few other tangible assets to consider. According to Mr. Sonnek, although they do not explicitly capitalize IC, they do it indirectly as this is the majority of the future value they see. The major factor within IC SEB VC consider is the management team and the unique knowledge they possess, and if this knowledge is sufficient to realize the company’s future plans, the IC factors is then a form of “yes or no”-factor whether to invest or not. When considering this they take both human capital, in form of the management team, in consideration, but also structural capital as distribution, logistics and such. All these factors need to be satisfactory in order for the investment to take place. If some IC-factors not are satisfactory, Mr. Sonnek stresses the importance that the entrepreneurs need to realize these themselves. If not, the investment cannot be conducted.

Regarding the explicit capitalization of IC factors, Mr. Sonnek sees no value added in dividing the present value of the company into these factors, as the financial calculations they conduct rather are backwards and that it is the future value of the company that is important. One does not need to know the value of the various factors, relative to others.

*“The concept of Intellectual Capital is, according to me, not as useful when considering small firms”* – David Sonnek, SEB VC

With the above quote he elaborates that the consideration of IC is more important for large corporations and private equity investors, due to the fact that the calculations are very specific in the venture capital industry.

#### **4.1.4 Ulrika Strömberg, Theia**

Theia Fond 1 AB is a business angel fund in administration of almost 13 million SEK, that are intended to be used for investments in growth companies in the Stockholm- and Mälardalen region. Today, the fund is comprised by approximately 40 private investors, where the majority of these investors are female with backgrounds in the business world. Theia invest in firms with strong entrepreneurial spirit where they have identified a strong potential for growth in the short term, regardless of what industry the company is operating in. These companies are ideally in the early stages of the business cycle and have obtained one or a few customers so far. Theia want to create value in their investments by being an active owner. Theia are ideally looking for an exit from its investments within three to five years (theia.se).

Ulrika Strömberg is one of three in the management of Theia and also one of the founders of Theia. Mrs. Strömberg is not only active in Theia though, she is investing both others and her own money in other situations as well and has been doing so for twenty years, thus she is labeling herself just “investor”. She has a background in investment banking where she has been working for, among others, Alfred Berg and Carnegie. Mrs. Strömberg has been working as an entrepreneur, private investor and financial advisor for a number of companies for a couple of years and is also on the board of a number of companies (theia.se).

##### ***4.1.4.1 Present Due Diligence Model***

Theia divide their due diligence in four parts: commercial-, technical-, legal- and financial due diligence. The legal due diligence is conducted by lawyers, the financial due diligence can be conducted by either an auditor or Theia do it themselves, the technical part is evaluated by outside expertise to the extent that Theia feel that it is beyond its knowledge, and the commercial due diligence is always conducted by Theia themselves.

#### 4.1.4.2 IC opinion

*“It can in very, very exceptional cases be that the entrepreneur is not the make or break-factor for the company. But that is so unusual that I have never experienced it.” – Ulrika Strömberg, Theia*

The evaluation of the entrepreneur or the management team is done before any of the four due diligence parts are commenced, since it is so important, according to Mrs. Strömberg. She sees the qualities and skills of the entrepreneur/management team as a “hygiene factor” as believing in the entrepreneur is necessary to commence the due diligence. The most revealing factor on whether the entrepreneur has the ability to start a successful business is if he/she has done it before. Doing the evaluation in a more structured way is not necessary according to Mrs. Strömberg since it would not improve the accuracy of the judgment. If it would exist a framework that can prove that looking at certain IC-factors such as management can improve the judgment and in the end the result of the investments, this would of course be valuable, but Mrs. Strömberg believe that the process of developing such a tool would take about twenty years and that it would not be worth it given the uncertainty of the expected results.

*“I would not pay a dime for this [IC Framework] unless I knew that it is better than my own judgment.” – Ulrika Strömberg, Theia*

Mrs. Strömberg says that she uses the concept of IC every day in her work, and she sees the structural capital as the most important part of the IC, as that is what she as a VC can have some sort of control over. The more structural capital a company has, the easier it is for her to invest in the company as even if the entrepreneur is gone, some of the value is frozen down in processes, patents, software, databases or other.

#### 4.1.5 Johan Söderberg, Create Business Incubator

Create Business Incubator (CBI) is owned by Västerås Science Park (VSP), which in turn is a innovation centre in the town of Västerås. Johan Söderberg is employed by VSP and has two differing tasks. He is both an advisor to start-ups within VSP seeking venture capital and helps them with the entire process of obtaining capital. Mr. Söderberg is also involved in the process of creating a new VC-firm, which will invest in corporations based on geographic preferences,

which in this case is Västmanland. In this new firm, Mr. Söderberg will be head of investments, which implies that he will be leading the due diligence process. One can therefore view Mr. Söderberg as both an expert on obtaining venture capital, and also as a venture capitalist himself. Prior to his present situation he has also been involved in getting venture funding in a previous venture.

#### *4.1.5.1 Present Due Diligence Model*

The business incubator is a government funded innovation centre where startups are given office space and support in the early stages. Mr. Söderberg underlines the fact that the incubator are much more lenient on who to allow space, and then supports these startups closely during the first months of their existence, why they therefore gain a very deep understanding about the business and also the entrepreneurs. When conducting the evaluation of startups, they use a framework to identify the market potential and business model. This framework also includes financial aspects in the costs to reach the desired market. The product of these factors then identifies the difficulty to actually succeed with the project.

#### *4.1.5.2 IC opinion*

As Mr. Söderberg is involved with very early startups, seldom with more than three entrepreneurs, he states that the founder's engagement, experience and knowledge, the human capital, is what really matters when evaluating business potential. When evaluating this, Mr Söderberg states that he mostly uses "gut feeling" as a complement to a structured process. The startup firms he is involved with are, as previously mentioned, in a very early stage and therefore Mr. Söderberg has the opinion that the due diligence of the entrepreneurs is even more important, as the firms often are yet to get their first customers.

During the time when he obtained funding for his own firm, he felt that the venture capital firms were much more thorough in their evaluation of the human capital than the business angels they were in contact with. The VCs interviewed numerous referrers who had experience from working with Mr. Söderberg and the BAs relied more on a few personal meetings. An aspect Mr. Söderberg has noticed is that the due diligence regarding the management team often is quite extensive, however on a deeper level, they often look past the ability to handle new employees, which also is very important.

*“All else equal, a better entrepreneur implies lower risk and should therefore imply a higher value” – Johan Söderberg, Create Business Incubator*

Even though CBI see IC as the most important factors in the startups they evaluate, Mr. Söderberg is convinced that there should be a way to conduct this evaluation in a more structured manner, why an IC-tool would be very helpful. He does however add that when evaluating people, it is always difficult to utilize a standardized tool. The IC-factors are not capitalized as the valuation of these startups is so difficult to conduct in the first place, as they have so few assets. In the end, he adds, it is rather a supply and demand-situation on how interesting the venture is that creates the value of the firm. Besides the actual valuation of the firm, Mr. Söderberg believes that the case is rather a yes or no-scenario, if they can obtain capital or not, and then the experience of the management team increase the chances of getting capital.

Customer capital and process capital can however affect the valuation of the firm. Whether this form of capital is explicit or tacit is very important to the riskiness of the project and also decreases the degree of how much the VC has to rely on the individual entrepreneur. This lower risk does affect the valuation positively.

*“The question is whether a framework is more useful for a VC-firm or an entrepreneur. As there is a shortage of capital on the market, it should rather be up to the entrepreneur to point out the value factors, including IC” – Johan Söderberg, Create Business Incubator*

#### **4.1.6 Richard Treffner, Investor Growth Capital (IGC)**

*“We here at IGC are known within the industry to conduct a more extensive due diligence than many of our peers” – Richard Treffner, IGC*

Investor AB is northern Europe’s largest investment corporation and IGC is their wholly owned venture capital leg. IGC is specialized in investments within Technology and Healthcare, with a geographical span from the US to Asia (www.investorab.com, 2010). At the present they are involved in around 100 investment projects. Compared to other VC-firms IGC invest in a relatively late stage and target companies with revenues around €5 million and invest around €5-30 million for each investment. Richard Treffner is an analyst and has the tasks to identify



profitable investments and to evaluate investment opportunities. He is involved in the process up until the investment is conducted.

#### **4.1.6.1 Present Due Diligence Model**

*“The due diligence process always looks about the same, but it is always different”* –  
Richard Treffner, IGC

Due to the size of the investments IGC conducts, they always hire consultants in the due diligence process. Generally they conduct a more basic pre-due diligence themselves, resulting in an approximate value of the target. When this value is somewhat set, they hire consultants to perform the more extensive due diligence regarding legal, financial and commercial factors. In the commercial due diligence IGC are more involved and often conduct a parallel such report. Besides these basic forms of due diligence, they also often hire HR-consultants to evaluate the individuals and the management team. Between these different forms of due diligence, it is often the commercial due diligence that is the most crucial and can result in a decision whether to invest or not. The HR-due diligence is also important; however its role is more often to find weaknesses, as they will not invest in a company based on very good HR-factors alone. Mr. Treffner does state that due to the late stage they invest, the management team is often quite knowledgeable and has a record of success.

When estimating the value of a target, they utilize scenario analysis in their traditional DCF-model, and in this incorporates all forms of due diligence implicitly.

#### **4.1.6.2 IC Opinion**

In Mr. Treffners opinion, patents, or intellectual property, are the most concrete form of intellectual capital. He does however define the term as the “entire value of the firm which is not found on a balance sheet”. Customer capital is a very fundamental part of their commercial due diligence, and they do a thorough analysis of their customer relations and their competition. A sub category to the commercial due diligence is the operational due diligence, where they take factors such as process and structural capital into consideration. The quality of these factors, he states, is a function of the time the company has been active, rather than its size. He stresses the importance of identifying key employees with a lot of tacit knowledge and the importance of

tying up these individuals for the future. Factors such as culture are also important and to get an understanding of this they interview members of the management individually. Regarding a more standardized IC-framework, Mr. Treffner states that there is always room for an improved model, however he does not see this as something crucial. When evaluating intangible intellectual assets however, he states that it might be difficult to use a standardized approach, as these assets differ extensively between firms.

## **4.2 Entrepreneurs**

### **4.2.1 Martin Lorentzon**

Mr. Lorentzon has been the leading entrepreneur during two start ups that have received venture capital backing. The first venture he created is TradeDoubler, which today is a multinational corporation and is listed at the Swedish stock exchange. The other is Spotify, which today has a solid customer base and, according to Mr. Lorentzon, will have a lot more to offer in the future. Both firms have strong IT-characteristics and therefore the opinions of Mr. Lorentzon are well prepared to represent this knowledge intense industry. During his career as an entrepreneur, Mr. Lorentzon have met with between 30-50 venture capital firms and therefore have a solid knowledge on the evaluation process these firms utilize. The experience of obtaining capital has differed widely between these ventures, as Mr. Lorentzon did not have extensive knowledge on the subject when seeking capital for TradeDoubler. However this situation was radically different during the Spotify startup, where Mr. Lorentzon initially invested a large sum of money privately as well. He underscores the importance of the structure of the deals and states that the structure tends to be more complex when you put the responsibilities in the hand of the VC-firms, as opposed to constructing the deal themselves.

#### ***4.2.1.1 Venture Capital Due Diligence Experience***

A statement Mr. Lorentzon often comes back to is the lack of knowledge in the VCs. He has acknowledged the fact that the VCs often try to market themselves with knowledge in the industry, contacts and so forth, but according to Mr. Lorentzon this is generally not correct and in the end it all comes down to who can pay the most money for the smallest share of the company – cash is king.

The VC due diligence process is, according to Mr. Lorentzon, one of the strongest competencies in the VC-firms. They really do their homework and thoroughly analyze all aspects of a business concept, and they are well aware of the fact that the entrepreneur is one of the most important factors. Interviews are a very important factor in the evaluation of a business concept and a very important factor is how well the entrepreneur is able to present and sell the business concept initially. In the opinion of Mr. Lorentzon, the factors which decide whether a venture will be successful or not depends 97% on the people and 3% on the business concept. He does however think that this is different for the VCs, where he estimates that the people constitute 50%, the business concept 25% and the valuation 25%. The valuation is a deciding factor that if unreasonable, even though the entrepreneur and business concept is good, will be a decisive factor not to make an investment.

#### **4.2.1.2 IC Opinion**

*“If one use a framework, then the results tend to be better, but I almost exclusively rely on my gut feeling and that has worked out fine” – Martin Lorentzon*

Mr. Lorentzon frequently states that the people and knowledge in a firm is the most important value driver. He is however not familiar with the taxonomy regarding intellectual capital, but during the interview it is apparent that both structural and human capital is of extreme importance. He further elaborates this by posing the question whether to use a framework or not and compares the due diligence process from the VC side with the hiring of new employees. The IC within a firm can, according to Mr. Lorentzon, affect the valuation of this firm tremendously and states that the high valuation of Spotify was due to the fact that he and his co-founder had so much experience, i.e. human capital, and would not have been possible otherwise.

When pitching a business concept however, Mr. Lorentzon states that the product and user experience is the focus. The IC is then the determining factor whether to invest or not. If the human capital is lacking, the VCs generally decline to invest. The reason is that it is very difficult to hire a person with the right competence in order to make the venture successful. That is why firms where the founder is the CEO often are the most successful in the technology sector, Mr. Lorentzon says, and drops Larry Ellison, Steve Jobs and Bill Gates as examples.

## **4.2.2 Dan Olofsson**

Having been called Malmö's greatest entrepreneur, Dan Olofsson has during his career been involved in building businesses which today employ around 6000 people. He is active within the knowledge intensive consulting and technology industries. His career started with the founding of Sigma, which he later privately acquired. Alongside being a successful entrepreneur, Mr. Olofsson is also an active long term investor in numerous businesses, why his dual approach to the concept of IC is interesting.

### ***4.2.2.1 Venture Capital Due Diligence Experience***

Important to note is that the majority of capital needed for businesses during the years has been provided by Mr. Olofsson himself, why he for a long time not has been dependent on outside capital. Similarly, when he started Sigma, he did this with his colleagues providing most of the financing. When Sigma was entering a growth state however, Mr. Olofsson was involved in the search of capital, which later was obtained based on prior relations and trust with financiers. This resulted in a non-typical venture capital evaluation due to the prior relation. Having been involved in a number of capital runs he has naturally also been denied capital at several occasions. When asking the question whether this could be due to the lack of IC-valuation by the VCs, Mr. Olofsson replied that this could be the case, but niched VCs can estimate the value of the knowledge in the firms quite well.

### ***4.2.2.2 IC Opinion***

Both in his own corporations and also in corporations Mr. Olofsson potentially will invest he utilizes a check list with IC-factors to determine the quality of the human capital within the target. This checklist is then used in combination with historic financial data to create a meaningful forecast of the future performance of the target. He mentions customer capital especially, as it is very important to take the relation with key customers in consideration and also in which stage these customers are – if large, reoccurring, customers are growing themselves, it is plausible to assume that the revenue from these customers will increase as well. The weakness of historic data is something Mr. Olofsson stresses, and continues with the statement that the future is much more important. The key to understanding the future is then IC.

Lastly, Mr. Olofsson's impression is that the consideration of IC from his perspective has been more or less the same since he started his first business in the 1980:s.

## **4.3 Other, Supporting**

### **4.3.1 Linus Dagh, Swedish Venture Capital Association**

The Swedish Venture Capital Association (SVCA) is a non-profit organization that is working in the interest of firms and private individuals that are active on the Swedish venture capital market. The association has the duty to work for a well functioning private equity market in Sweden, to spread knowledge among the general public and to work for professional development and to encourage entrepreneurship.

Linus Dagh is working as an analyst at SVCA and he is analyzing the market for developments in private equity and venture capital. He is analyzing all sectors of the market for where there is a lot of activity and where there is a lack of capital.

#### **4.3.1.1 IC opinion**

Mr. Dagh says that his view and the general view in the industry is that the entrepreneur/management team is the most important factor to analyze when evaluating a business opportunity, more important than the idea. Especially within venture capital since the investor becomes the minority owner. Mr. Dagh says that the intuition of the entrepreneur should not be underestimated. The concept of a human due diligence where the entrepreneur/management team is thoroughly examined has also increased in popularity in recent years. One thing Mr. Dagh think is extra revealing for the capabilities of the individual is what he/she has achieved before. Mr. Dagh is of the opinion that if there are any doubts about the traits of the entrepreneur, all VCs will chose not to do the investment.

Mr. Dagh is not sure whether there is a need for more structure regarding the evaluation of IC. He thinks that the need for that is very dependent on what background the VC has. Since VCs have such diverse backgrounds as consultants, bankers or entrepreneurs, the way they work differs very much and so does their needs for a framework to help in this matter. He thinks that a way to simplify how to evaluate the rigidness of patents would be very useful though, if it would result in entrepreneurs not having to hire outside expertise to do the evaluation.

Mr. Dagh further thinks that the earlier in the business life cycle the investor is looking to do an investment and the less experience the investor has, the bigger the need is for a framework to capture important IC factors. He says that business angels in general are very interested in frameworks of different kinds and how other investors are thinking regarding different issues in the investment process.

#### **4.3.2 Magnus Rembacken, PriceWaterhouseCoopers Transaction Services**

This was a rather brief interview with Magnus Rembacken at PwCs Transaction Services-department, which is a consulting branch within PwC with the focus on providing consulting expertise regarding M&A. During the interview Mr. Rembacken mentioned one interesting fact, which is that the venture capital firms which they consult do not ask for IC-consideration from PwC, but rather hire them to do a financial due diligence. We believe that this interview represents the general situation regarding M&A-consultancy.

#### **4.3.3 Rickard Sohlberg**

Mr. Sohlberg is an experienced entrepreneur and business angel that have been involved in the start-up of many companies as well as making investments himself. He sees himself as a business angel today and is active in many projects, among them the Scarptor Consulting AB. Mr. Sohlberg first got in contact with IC in the middle of the 90's when a company that he was involved in got a very high valuation due to immaterial factors. This made him interested in the concept of IC and he got in contact with Leif Edvinsson. Mr. Sohlberg has since then been an avid thinker on the subject of IC and has been in contact with it on a daily basis.

##### **4.3.3.1 IC opinion**

When Mr. Sohlberg is talking about IC, he thinks that the most vital part is to identify and evaluate the company's sweet spot. The sweet spot is what makes a company unique and that can make a company successful. The sweet spot can be a patent, a customer contract, a specific concept or skill. This sweet spot is almost always an intellectual capital factor, and if the company does not have a sweet spot it will be very hard for it to be successful.

Human capital factors are what Mr. Sohlberg is looking at the most when he is looking at the IC of a company. This is of course dependent on where in the business life cycle a company is

though. When a company is in the early stages, such as seed or start-up, and when business angels evaluate whether to invest or not, there is not much in place in the company except the entrepreneur/management team. It is thus normal for a business angel to mostly look at human capital factors. Investors in later stages should be more concerned with other IC-factors as well, according to Mr. Sohlberg.

When Mr. Sohlberg is evaluating IC, he is doing it mostly by trusting his gut feeling. Since he has got so much experience in evaluating start-ups, he feels that it is an adequate method. He says that it would be useful for less experienced investors to have a framework to follow. It would also be useful for more experienced investors such as himself to have a framework if it could help determine the company's ability to create value in the future. Capitalizing the intellectual capital on the balance sheet of a company is not useful per se, but if it would be evaluated on the basis of how it will help the company to create value in the future then it can be very useful.

The effect an entrepreneur/a management team can achieve if properly knowing the different parts of IC can be huge, according to Mr. Sohlberg. He is telling about when he once created a company by adding the different IC-parts of other companies together, and thus reached a much higher valuation than what the parts were valued to on their own.

Mr. Sohlberg's opinion on the general notion of IC in Sweden's business life is that it is at a road junction: the importance of IC can either be further appreciated or it can decrease. A lot of people have a notion of what it is, but few know how it can help them in their work.

The importance of IC can be seen in other parts of the world as well. Mr. Sohlberg is telling about the increased interest in the subject among the Chinese business world as some parts of their economy is moving from merely producing to building brands as well.

## 4.4 Empirics Compilation

In the table below we have compiled the most important results from the interviews with Venture Capital firms. In the far right column, IC Opinion, we have ranked their view on the topic of IC after importance on a scale from 1 to 5.

VC-Firm	Respondent	Key Takeaway	IC opinion
HealthCap AB	Johnas Hansson	Human Capital is a Yes/No-factor, Customer capital and IP in healthcare industry is very important	4
Creandum	Staffan Helgesson	Good understanding of IC. The individuals the most important factor	5
SEB VC	David Sonnek	IC constitutes the majority of value in a startup. If lacking, the management team need to realize this	4
Theia	Ulrika Strömberg	IC-framework likely not better than personal judgement	3
CBI	Johan Söderberg	Human Capital not only management, must be able to manage new employees	5
IGC	Richard Treffner	Hire consultants on all aspects, but conducts a parallell report themselves	5



## 5 Analysis

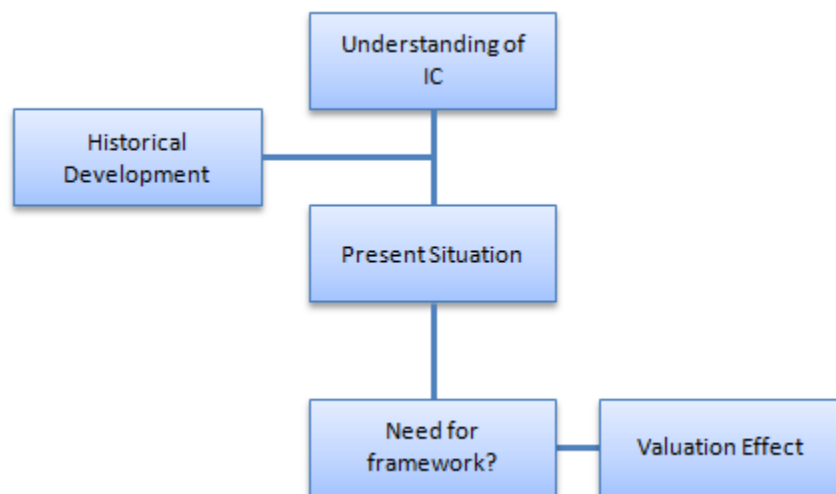
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*In this part we will firstly present a disposition of our analysis. We will then move on by analyzing our empirics using the theoretical framework presented in chapter 3. The analysis will begin with our view on the understanding of IC among the respondents and then continue to describe our analysis on the historical development and present situation. The chapter will be ended by an analysis of the need for a framework to account IC among VCs and the effect the present consideration of IC-factors has on the valuation of an investment opportunity.*

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### 5.1 Analysis Disposition

In accordance with the structure shown in the illustration below, we will begin our analysis with a discussion regarding the general understanding of IC as a concept among VCs and which implications this might have for our analysis. After this we will provide a brief discussion regarding the historical development which is the foundation for the present situation. The present situation will in turn be broken down in our analysis in order to understand the various aspects of IC, how they are taken into account and which factors that is top-of-mind among the VCs. The present situation then constitutes the starting point upon which one can analyze how the IC-factors could be taken into account in the future and if there is a need for a framework. Following this discussion we will conclude our analysis with a discussion on the valuation effect of the consideration of IC.



## 5.2 Understanding of IC

Our interviews point to a general confusion amongst the VCs regarding what the taxonomy of IC is and which factors are included. Some of our respondents were however familiar with the subject and could therefore appreciate the importance of these factors. When researching what impression they have of the subject, almost everyone referred to the human capital, and thereby failed to recognize the other factors. This result will be further analyzed in the present situation-section.

## 5.3 Historical Development

During our interviews, this topic has been given quite disperse responses. The importance of the human capital has however always been one of, if not the, most important factors VCs consider when evaluating investment opportunities. A few of our respondents did however recognize the theory of IC as being proposed in the 90's, but added that this was nothing they ever considered incorporating into their evaluation philosophy. According to our analysis of the responses, we got the impression that the evaluation of investment opportunities has been an organic process where the present situation is a result of expertise rather than concrete decisions.

## 5.4 Present Situation

In order to understand the present situation, we will begin the analysis by describing it in general terms, and then continuing with a more in-depth analysis of the incorporation of specific IC-factors, relative to the general VC due diligence framework (exhibit 1) and the 10 EFFAS principles.

During our interviews we see a clear distinction between soft and hard factors in the evaluation. One can describe the soft factors as the qualitative evaluation of human factors within firms, market evaluation, customer evaluation and such. The hard factors are quantitative legal and financial factors. The result we got is that VCs generally tends to follow this division of factors, and that they tend to outsource the evaluation of the hard factors to consulting and legal firms, and consider the soft factors themselves. This fact was often motivated by stating the extreme importance of the soft factors and that it is the evaluation of these that sets a specific VC-firm apart from all others – it is their competitive advantage. We find these results intriguing as they

suggest a clear appreciation of the basics of IC. The question is then which of the IC factors they put most emphasis on. We will also try to find patterns where they tend to disregard specific IC-aspects, as this is of great importance to the analysis of the present situation. Following the IC value scheme, presented in chapter 3.2.1, we will evaluate each factor in the context of the VC due diligence process.

Human capital, as stated earlier, is and has always been, very important for the VC-firms. They unanimously stress the importance of knowledge and experience in the entrepreneurs and the management team as a key indicator of the probability of success of the venture. This fact is also reflected in the general VC DD-template as the 10<sup>th</sup> topic, “Management and Personnel”. However, when analyzing the factors included in this topic we find that the factors to be analyzed are rather quantitative rather than qualitative, it is in regards to the credit history of management and so forth, why it fails to incorporate the human capital factor. The question is then why such an important factor is not evaluated on a more structured basis, and if this can lead to a situation where the VC fails to appreciate the quality why a more structured analysis would be value adding. Our analysis suggest that many VCs claim that intuition play a great part in this evaluation and that due to the fact that every individual is unique, a structured evaluation may be misleading anyways. Some of the larger firms respond that they in some cases utilize HR-consultants in order to do this evaluation, but the results from these are rather a complement to their own analyses. The tacit knowledge of key employees is also very important and this evaluation is explicitly stated to be evaluated only by a few of our respondents, why this factor could be important in a potential framework. In summary, human capital is carefully taken into consideration, but is however not presented in a structured manner, but is rather an overhead-factor when deciding to invest or not. This also implies that the 10 EFFAS principles are not followed, as the factors are not explicitly reported at all.

To continue with Edvinsson’s IC value scheme, we will now analyze how the structural capital is taken into consideration. Structural capital is something which is dynamically evolved within corporations and, as one of our respondents say, the quality is rather dependent on the age of the company than of the size. From our empirics, it is apparent that structural capital is very important to VCs as well, especially as structural capital is comprised of all factors below in the value scheme. It is difficult to analyze this factor without acknowledging these other factors. To

continue with the analysis of the structural capital we will therefore analyze the independent factors in each stage below the structural capital and combine these to create a holistic view of the present situation.

We have received diverse responses regarding customer capital. The overall feeling is that when it comes to larger investments, customer capital gains importance. The evaluation of this factor is according to our respondents dependent on interviews with key customers to then discern their opinions of the investment opportunity. This factor is then bundled with the other qualitative factors to create a decision base whether to invest or not. In the general VC-DD template one can find the customer capital under the Marketing-topic, this does however only look at quantitative factors such as a list of major clients, and does not explicitly call for an evaluation of these. The organizational capital, also deemed to be very important, is comprised of innovation and process capital. The process capital is one of the factors which we as researchers feel that there might be a lack of acknowledgement as this term was never used by our respondents explicitly and the terms meaning was not extensively discussed. A reason for this might be that the ventures evaluated often are quite young and the VCs feel that the processes needed for a successful business is something they can provide. Our interviews with entrepreneurs does however point to that the VCs overestimate their ability to provide knowledge as they often invest in multiple firms simultaneously and therefore do not have the resources to get acquainted with individual firms. Innovation capital is however, naturally, very important to the VCs. The product or service they venture offers is a result of innovation and it is the basis of their business concept. Intellectual property, or patents, is a term explicitly mentioned by most of our respondents. This fact is also reflected in the general VC DD template under Products and Services and Research and Development.

## **5.5 Need for a framework?**

In this part we use our interviews and theory to analyze whether there is a need for a framework to evaluate the IC factors in a more structured way by capitalizing them. As we have stated previously in our analysis many IC-factors are taken into consideration by VCs when they evaluate investment opportunities, but it is often done in a rather unstructured way. The question

is then if it would be valuable for a VC to have a framework that can help them account these factors in a more structured way.

Most respondents answer this question in a precautionous way; they of course think that it would be valuable if it was statistically proven that it would help them evaluate their investment opportunities in a way that in the end gives them higher returns on their investments. But the likelihood of someone developing such a framework is very low according to many respondents as the time frame needed to do it would be too extensive, and the probability of a beneficial result would still be very uncertain. Furthermore, many respondents that have been in the business of evaluating investments for a longer time are skeptical as they have more trust in their own judgment more than they would in a framework.

Based on the discussion above, our analysis points to that the VCs do not see a specific need for a framework. This is however a result one can expect, as their present methods have been used for a long time and it is difficult to see value in something new. One respondent did mention that a more structured framework would perhaps minimize the risk for the VCs to overlook important IC-factors, but the question is whether this benefit is larger than the previously mentioned cost for developing such a framework. Another interesting point is what party in a VC investment would benefit the most from a framework, the startup firm or the venture capitalist? At present there is an excess of firms that seek venture capital and a limited supply, why it is perhaps up to the entrepreneur to point to the quality of the IC, why a framework would be more beneficial to him. Also, as one of our respondents point out, the valuation used when investing in startups is quite different from the one used to value large, mature, businesses. The respondent, who was quite knowledgeable regarding IC, saw more value in a structured IC evaluation when valuing larger corporations, as they have larger gaps between book value and market value. Further, the VCs have a unique insight in their investment opportunities as they require the entrepreneurs and the management team to disclose all information regarding their business prior to the investment, why the ability to evaluate their IC could be greater compared to a regular stock market investment.

## 5.6 Valuation Effect

When asking our respondents whether the intellectual capital of the firm affects the valuation, many of our respondents have answered that it does not, and that it rather is of such importance that it is a deal breaker. The confusing thing has been that most respondents then have referred only to the human capital when answering if IC-factors affect the valuation. So what they have answered is really that if the entrepreneur/management team does not meet the standards that the VC has, there will be no investment. It is not a factor that will change the valuation of the company, it is a factor that will decide if they will invest or not. It is also a factor that will decide if they will make a valuation or not, since the evaluation of the entrepreneur/management team is often made before the valuation of the company is commenced. Some of the VC respondents have said though that if the entrepreneur/management team is regarded to have exceptional knowledge or experience, they are willing to pay a premium for that. This has also been experienced by one of the entrepreneurs that we have interviewed, as Mr. Lorentzon said that they received a higher valuation for Spotify since he as an experienced entrepreneur added value to the company. The analysis is thus that the picture is diverse but that human capital in some cases affects the valuation.

If we move away from human capital in our analysis and look at other IC-factors, the picture is quite clear. Factors such as customer capital, process capital and intellectual property affect the VCs valuation to a large extent. When the VCs we have interviewed value their investment opportunities all of them evaluate the parts that are included under structural capital in the IC Value Scheme, even though they are not doing it in exactly the same way and they are not doing it in accordance to the IC Value Scheme. Most VCs include the structural capital parts in what they call the commercial due diligence, and the analysis is that this to a large extent affects the valuation of the company since this part is seldom outsourced as VCs regard the evaluation of this part their competitive advantage. Using the theoretical framework of different valuation methodologies, we can make the analysis that the structural capital can affect the VCs judgment on the investment opportunity as VCs see the structural capital as a sort of asset since they feel that they have some control over it. The human capital cannot be controlled as the people in the organization can quit any time they want. VCs therefore see structural capital as very important and as something that in a direct way can affect the valuation of the company. And the fact that

most of the parts included in the structural capital are important parts in the VCs commercial due diligence shows that IC-factors to a large extent affect the valuation.

Further analysis on our empirics strengthens the view that the different IC-factors can affect the valuation of an investment opportunity. Our empirics show that when adding certain parts of different companies that are strong on different IC-factors together, one can reach a higher valuation of the new company than the value of the parts separately.

## 6 Conclusion

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*In this chapter we present our conclusions based on the conducted analysis. This conclusion will be the basis for the key takeaways presented. Afterthought and retrospection will also be presented, which has the purpose to be able to present suggestions for future research on the subject and also to describe the knowledge journey we have traveled while writing this thesis.*

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In our analysis we have found a number of important implications regarding our purpose which we will present here in our conclusion. Firstly, although the concept of IC is generally not explicitly evaluated within the VC-industry, the factors included in the theory proposed by L. Edvinsson et al are almost all considered to be very important to the VC-firms. Using the IC value scheme as a reference point and benchmarking this with the general VC DD-framework we see that even though the factors were not present in the framework, they were very present in the minds of the VC-employees executing the evaluation of new investment opportunities. The IC is then, according to our analysis, very important to the venture capitalists, but the evaluation of its factors is not conducted in a structured manner. Instead, the factors were qualitatively evaluated as a part of each VC-firms competitive advantage and to facilitate this qualitative evaluation, the required information from the entrepreneurs and the management team is extensive. The reason for this, according to the VCs, is that the situation for each new investment opportunity is unique and requires analytical thinking, which might be difficult to incorporate in a framework. Another reason is that the evaluation at present is according to themselves sufficient to make a correct decision whether to invest or not and that a framework would be too costly to develop and implement in comparison to its perceived benefits.

Interesting is the fact that there is a surplus of ventures seeking capital in relation to VC-firms, why it perhaps rather should be in the interest of the entrepreneurs to utilize a framework in order to successfully pitch their business concept together with the IC and to get the much needed capital. Our conclusion is therefore that the VC-firms take almost all factors within IC into consideration at the present, but due to their unique insight in the firms they invest in, in combination with their rather unique way of calculating the value of the target, they do not have to structure this input in order to utilize the information in an effective manner and we do not believe that profitable investment opportunities are missed due to a non existing IC-framework.



In fact, if they miss an opportunity due to failure to appreciate the value of the IC within the target firm, then perhaps this is just as well as they would have difficulties understanding the business in the future, which is imperative for a successful investment.

Further conclusions we made was that the 10 EFFAS principles on how to report IC are not followed, which is natural as the it is impossible to follow the principles without utilizing a structured way of evaluating IC.

Regarding if the IC-factors in the IC Value scheme affect the valuation of investment opportunities the conclusion is that they to a large extent do. Human capital can in some cases lead to that the VC pays a premium, and the other factors under structural capital affect the valuation to a large extent since they are included in the commercial due diligence, which most VCs see as their competitive advantage and thus is the most deciding factor for the valuation.

## 6.1 Key takeaways

- One key take away from the results of this thesis is that there is a general confusion among VCs regarding the taxonomy of IC, and that the VCs actually think of human capital when they hear the expression intellectual capital.
- This confusion is maybe because the human capital is without doubt what VCs think is most important among the IC-factors and all other factors as well. The perceived human capital of the investment object is almost in all cases a deal breaker on whether the VC will make the investment or not. The judgment of the human capital is like a road junction: if the VCs feel that the human capital is not sufficient, they will not commence the due diligence.
- Based on our analysis, we do not feel that there would be a value in structuring the process of appreciating IC in another way than it is done today.
- All parts of the IC value scheme are covered in the due diligence processes of VCs, but the processes are not structured in accordance to the IC value scheme, and they are not structured in the same way among VCs.

- IC-factors affect the valuation of the investment opportunities. Human capital do affect the valuation for some VCs, and the parts included in the structural capital are often included in what VCs call their commercial due diligence, which is regarded as their core competence and the diligence affecting the valuation the most.
- Based on these key takeaways, our conclusion is that the VCs do take IC into consideration in a satisfactory way.

## 6.2 Suggestions for future research

After the completion of this thesis we found a few further questions which we see as valuable to answer. The first of these is to further analyze potential effects of implementing a structured framework and also constructing such a framework. Further research would also be needed on which party in a venture capital transaction that would benefit the most from such a framework. Lastly, we would suggest future researchers to investigate the possibility of capitalizing the IC-factors in order to achieve a better foundation to find the potential future value in new investment opportunities.

## 6.3 Knowledge Journey

To finalize this thesis we will in this chapter describe the knowledge journey that has taken us to the final product. As usual when one embarks on the mission to create a contribution to the research frontier, one starts out with one thought of what the final product will be, but end up presenting something entirely different, dependent on obstacles and new information along the way. The initial purpose was to present the framework suggested in chapter 6.1, however this proved to be a too comprehensive task due to our limited access to information from the venture capital industry as well as the difficulty to get in contact with representatives of the VC-firms. This insight made us revise our initial purpose to the one we now have presented above. Furthermore, when digging deeper in the subject of venture capital financing, our eyes were opened to the vast excess of ventures seeking capital compared to the venture capital firms, which made us think who would benefit the most from a framework, a question which we also have suggested as future research. Finally, the theories regarding intellectual capital and all of its components we found, to our surprise, to be considered on a rather extensive manner by almost

all venture capitalists, so perhaps the main point of the conclusion of this thesis as well as to our knowledge is one where venture capitalists do put very much emphasis on intellectual based capital, but not in the structured way as the IC value scheme suggests.

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## 8 Appendix

### Appendix 1: The Venture Capital Due Diligence Process (Corey Pierce, 2007)

#### 1. Corporate Documents:

- Articles of Incorporation
- Bylaws and operating agreements
- Shareholder agreements
- Minutes of Board of Directors and Shareholder meetings
- All documents furnished to shareholders and directors
- Certificates from all states and jurisdictions where the company does business

#### 2. Previous Securities Issuance:

- Copies of stock certificates, warrants and option agreements
- Complete Stockholder contact information
- Number of outstanding shares, dates of issuance, and percent ownership
- All outstanding preferred stock, including covenants
- All outstanding options, warrants or convertible securities
- Employee stock benefit programs; stock options, stock purchases or others

#### 3. Financial Information

- Audited financial statements since inception
- Income statements, balance sheets, cash flow statements
- Records of all changes in equity position
- Accounting methods and practices
- Company prepared monthly or quarterly statements
- A three year budget and financial projections
- A complete and current business plan
- Accounts receivable aging and accounts payable aging
- Product or service pricing plans and policies
- Revenue and gross margins by product or service
- Extraordinary income or expense details
- Explanation of any material write-downs or write-offs
- A summary of all bad debt experiences
- Details of any outstanding contingent liabilities
- Accountant report on the company's financial condition

#### 4. Tax Status

- Federal and state income tax returns for the last three years
- Detail of any tax audits

#### 5. Contracts and Agreements

- List of Bank and non-Bank lenders
- Joint venture and partnership agreements
- License agreements

Purchase agreements  
Liens, equipment leases, mortgages or any other outstanding loans  
Insurance contracts and agreements  
Contracts with suppliers, vendors and customers  
Any additional agreements or contracts relevant to the business of the company

## **6. Governmental Regulations**

Copies of all permits and licenses  
Copies of reports made to government agencies  
Detail of any inquiries made by any local, state or federal agencies

## **7. Litigation**

Description of any current litigation including potential damages  
Description of any potential litigation including potential damages  
Settlement documentation

## **8. Products and Services**

Detail of product offering including market share by product line  
Inventory analysis including turnover, obsolescence and valuation policies  
Backlog analysis by product line including analysis of seasonal issues  
List of all major suppliers including dollar amount purchased per year

## **9. Marketing**

List of competitors and detail of market share  
List of major clients  
Analysis of pricing strategy  
Current brochures and marketing materials  
Sales commission structure  
Sales projections by product line  
Any pertinent marketing studies conducted by outside parties

## **10. Management and Personnel**

Management organizational chart and bios of senior personnel  
Detail of any labor disputes  
Employee compensation plans including pension, options, profit sharing, deferred compensation and retirement  
Management incentive plans including pension, option, profit sharing, deferred compensation, retirement and any non-cash compensation  
Employee confidentiality Agreements  
Listing of any consulting Agreements  
Number of employees, turnover, absentee problems and hiring projections  
Employee HR, benefits, and insurance manuals  
List of Company's Directors  
Pinkerton investigation report on all principals, managers, and directors  
Credit history report on all principals, managers, and directors  
Resume verification on all principals, managers, and directors



## **11. Property and Equipment**

An appraisal of all equipment and fixed assets  
List of all real property owned by the company  
Copies of titles, mortgages, and deeds of trust  
Detail of any easements or other encumbrances  
Leases and sub-leases  
Company space expansion plans  
Patents, trademarks and other intangible assets

## **12. Research & Development**

Detail all research and development in progress  
Commercial analysis of R&D efforts  
Documentation policies including examples

## **13. Other Company Information**

Copies of all past and planned company press releases  
Existing articles relating to the company and its industry  
Company newsletters and any investor relations material

## **14. The Kitchen Sink**

Any other information that might be pertinent to full disclosure of all company issues

## **Appendix 2: Supporting Interview Questions**

These are the supporting questions we sent out to respondents. The information includes a brief overview on what the purpose of the thesis is and also specific questions to venture capital firms and entrepreneurs. Please note that the material was supplied in Swedish and that the translated version is marked by italics. Also note that these are general questions and that they do not constitute an exact image on the structure of the semi-structured interviews.

### **2.1 General information**

Vi är två mastersstudenter som studerar på Corporate and Financial Management-programmet vid Lunds Universitet som skriver en uppsats om Venture Capital och hur VC's ser på Intellectual Capital när de utvärderar sina investeringsobjekt. I vår research har vi tittat på olika artiklar som visar att amerikanska och brittiska investerare tycker att trovärdighet hos entreprenören samt uppskattad kunskap och uppskattade egenskaper hos management teamet är de viktigaste faktorerna när de utvärderar sina investeringsobjekt<sup>1</sup>. Vi har även tittat på studier för svenska

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<sup>1</sup>Sudek, R., (2007) *Angel Investment Criteria*.

VC's som visar på liknande resultat<sup>2</sup>. Syftet med vår uppsats är att ta reda på hur VC's hanterar dessa, samt andra Intellectual Capital-faktorer i sin due diligence process.

*We are two master students at the Corporate and Financial Management program at Lund University. We are writing a thesis regarding Venture Capital and how the VCs consider Intellectual Capital when evaluating investment opportunities. During our research we have looked at articles showing that American and British investors regard trust worthiness in the entrepreneur and knowledge as appreciated traits in a management team when evaluating investment opportunities. We have also looked at studies regarding Swedish VCs which show similar results. The purpose with our thesis is to research how VC stake these Intellectual Capital factors in consideration in their due diligence process.*

## **2.2 Sent to venture capital firms**

Inledande övergripande informationsfrågor gällande roll inom företaget etc.

*Introductory information questions regarding title within company, company profile etc.*

Har ni någon nisch på era investeringsobjekt?

*Do you have a specific niche on your investments?*

Gör ni er due diligence själva eller har ni konsulter som gör den åt er?

*Do you conduct your due diligence your selves or do you hire consultants?*

Vilken bild har ni av IC generellt?

*What is your general view on IC?*

Vad anser ni om vikten av DCF (eller dylikt) generellt, och i förhållande till IC?

*What is your opinion of DCF (or similar frameworks) generally, and in relation to IC?*

Vilka faktorer är viktigast för er när ni utvärderar investeringsobjekt?

*Which factors are most important to you when evaluating investment opportunities?*

Tar ni IC i beaktning när ni utvärderar investeringsobjekt?

*Do you consider IC when evaluating investment opportunities?*

- På vilket sätt? (faktorer?, kapitaliserat eller som mjuka värden?)

- *In what way? (Factors?, Capitalized or as soft metrics?)*

- Kan ni ge några konkreta exempel på hur ni har tagit IC i beaktning?

- *Can you provide concrete examples on how you take IC in consideration?*

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<sup>2</sup> Anchér, C., och Ersmark, V., (2008) *Venture Capital – en undersökning av svenska venture capital-bolags investeringskriterier.*

Uppskattar ni IC i era investeringsobjekt på ett sådant sätt att det påverkar värderingen av företaget?

*Does the consideration of IC effect the valuation of your investment opportunities?*

Hur har utvecklingen på inom detta område sett ut historiskt?

*How has this area developed historically?*

Anser ni att ett verktyg för att kapitalisera IC behövs?

*In your opinion, is there a need for a tool to capitalize IC?*

Har ni någonsin missat lönsamma investeringsmöjligheter pga bristande IC-beaktning?

*Have you ever overlooked profitable investment opportunities due to lacking IC consideration?*

## 2.3 Sent to Entrepreneurs

### Tänkta frågor / Preliminary Questions

Inledande övergripande informationsfrågor gällande roll inom företaget etc.

*Introductory information questions regarding title within company, company profile etc.*

Vad är/var er affärsidé?

*What is/was your business idea?*

Vilken bild har ni av intellektuellt kapital generellt?

*What is your general view on intellectual capital?*

Vad har ni för bild av riskkapital-marknaden generellt?

*What is your general view on the venture capital market?*

Utmärkande drag?

*Specific traits?*

Positiva & Negativa aspekter?

*Positive & Negative aspects?*

Hur hittade ni VC-bolaget? Varför valde ni dem (pengar, kunskap etc)?

*How did you come in contact with the VC-firm? Why did you choose them (money, knowledge etc)?*

Vilka krav ställdes på er som entreprenörer inför VC-bolagets utvärderingsprocess?

*What was require from you as entrepreneurs prior to the VC-firms due diligence process?*

Fick ni några nej innan ni fick riskkapital? – varför?

*Were you declined prior to receiving venture capital? Why?*

Vad fokuserade ni på i er pitch? Varför?

*What was your focus in your pitch? Why?*

Vad kände ni att VC-bolaget fokuserade på?  
*What did the VC-firms focus on, according to you?*

Upplövde ni att VC-bolaget kunde uppskatta värdet av IC? Hur gick de till väga?  
*Did you feel that the VC-firm could appreciate the value of your IC? What did this process look like?*

Känner ni att det skulle vara användbart med en mer standardiserad utvärderingsprocess av IC?  
*Do you feel that it would be useful to use a more standardized evaluation process regarding IC?*

Om ni hade varit i VC-bolagets position, hade ni gjort något annorlunda?  
*If you were in the VC-firms position, would you have done anything differently?*