LUNDS UNIVERSITET
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# Corporate Governance Strategy in Swedish Venture Capital Firms

## – A Comparison between Governmental and Private Venture Capital Firms

**Supervisor:**
Claes Svensson

**Authors:**
Fredrik Ormberger 861222-4116
Mikael Törnqvist 860130-0034

# Preface

This thesis has been created during the course BUSM36, Degree Project in Corporate and Financial Management- Master Level at Lund University, spring 2011. The course is the last element in the one-year master program.

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Fredrik Ormberger Mikael Törnqvist

# Abstract


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| **Title:** | Corporate Governance Strategies in Swedish Venture Captial Firms – A comparison between Governmental and Private Venture Capital Firms |
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| **Five key words:** | Venture Capital, Corporate Governance Strategy, CGS-Model, Private and Governmental VC firms, Means of Corporate Governance |
| **Purpose:** | The purpose of this study is to describe and compare the corporate governance strategies of private and governmental VC firms. |
| **Methodology:** | This study uses a qualitative abductive method and conducts five case studies. |
| **Theoretical Perspectives:** | The authors formulizes a framework based upon Beuselinck (2007) |
| **Empirical foundation:** | The empirical data comes from five interviews conducted with investment managers from two private and three governmental VC firms. |
| **Findings:** | The authors find that even if private and governmental have similar strategies, some differences could be found. Private VCs seem to work closer to the investments in a more tailored manner. The authors also construct a model that can be used to compare, evaluate and formulize corporate governance strategies. |

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# 1. Introduction

*In this introductory chapter we will discuss the background of the thesis which will lead us towards a problem discussion. The background and the problem discussion then guide us to the purpose of the thesis.*

## 1.1 Background

The Swedish venture capital association, SVCA, explains that venture capital (VC) providers are professional investors with an aim to provide economical return to their financial providers (SVCA, 2011). Further, the VC companies often possess a high level of professional experience, and do therefore provide their portfolio companies with financial-, strategic- and organizational knowledge.

According to Rubin (2009) the first modern VC firm was American Research and Development (ARD), which was designed to help finance "noble ideas" rather than to generate return for investors. But during the last two decades, after VCs have financed the growth of current giants such as Microsoft, Google and Oracle, much of the focus has shifted to value creation through financial returns (Rubin, 2009; Jeng & Wells, 2000). However, the governmental VCs are still an important provider of venture capital and has an elevated focus on social returns. Social returns include economic development in rural areas, creation of high-quality jobs, and increasing wealth for women and minority groups and creation of products that benefit society (Rubin, 2009). The government, particularly in the Nordic region, has always been an important provider of VC investments. During the aftermath of the financial crisis, the governmental VC investments remained at a stable level whilst the investments decreased in general. The governmental investments rose to contribute to more than 30% from around 5% before the crisis (EVCA 2010 Nordic Report, October 2010).

As previously mentioned, VCs does not only provide financial capital, but also professional experience. One important source of this is through corporate governance, in which VCs can monitor and guide the investments (Cable & Shane, 1997). Corporate governance is about owner exercise of power within an organization in respect to a management and ownership separation (Tricker, 2009). In order for investors to feel safe in their investments, they need to be confident in the business model and how it is managed. This can only be assured by forming a solid corporate governance strategy that provides transparency and potential for

knowledge sharing (Mallin, 2010). A corporate governance strategy refers to the process of which corporate governance is utilized in a corporation.

Corporate governance in a VC setting has a lot to do with the relationship and interaction between the entrepreneur and the investors, which has been given extensive attention in research (Subhash, 2009; Kleinschmidt, 2006). This can be explained by the conditions when one part with an excellent business idea seeks help from an external part with both financing and management advice, where the effect from their cooperation is diluted ownership and increasing monitoring. Despite the fact that both the entrepreneur and the VC often share the same goals, the way towards success may not always look the same from these different perspectives (Khanin & Turel, 2009). The entrepreneur often has unique knowledge in technical aspects such as how to construct the product or how to develop the system, but they also in most cases lack the experience from running a company considering both strategy and finance. This is where the VCs comes in and contributes with their long-time experience but in spite of how good this match may look like, there also are some potential hurdles threatening the collaboration between the parties (Kleinschmidt, 2006). Due to their heterogeneous backgrounds and competences, and the fact that they have to structure a deal where the entrepreneur gives away some ownership to the VC, it may result in a situation where the cooperation does not work well at all (Khanin & Turel, 2009). In many big public companies, the governance work consists of conformation of rules due to new legislation and where a group of homogeneous people should make sure that the firm in heading in the right direction (Tricker, 2009).

Since the actors on the venture capital market raise funds from different sources, some are governmental VCs and others are private venture capitalists, they also have different objectives of what is most important with their investments. The private venture capitalists seek a reasonable return on their investments considering the high risk and governmental VCs have other incentives that go beyond the economic perspective. They invest in small business firms as a way of taking their social responsibility by stimulating innovation and growth in the different regions (Fisher, 1988). Generating new jobs is important and by investing in new business ideas the government makes sure that the creation of new jobs will continue. It has also been shown that governmental VCs are less sensitive to making an exit (Jeng & Wells, 2000) and that private VCs are more active with their counterpart than for example governmental VCs (Bottazzi, Hellmann & Da Rin, 2008).

## 1.2 Problem discussion

The importance of the collaboration and relation between the entrepreneur and the VC should, according to Cable & Shane (1997), not be underestimated. They compare the situation where a VC invests in a new idea and an entrepreneur with the prisoner's dilemma. Due to the uncertainty of the cooperation and information asymmetries the dynamics of this dyad should be carefully considered. Maybe this is the case, that there is a psychological aspect in the relationship between these two parties which has a major impact on the future performance.

Kleinschmidt (2007) argue that because of the high business- and agency risk in the venture capital industry, the need for good corporate governance strategies is huge. In his book he also mentions different agency problems such as, moral hazard[1], adverse selection[2] and hold-up[3] problem, as potential threats for the collaboration which could be reduced by good corporate governance. Good corporate governance helps the VC decrease the information asymmetries which facilitates the decision-making process with the result that more well-founded decisions are executed. In the end this should lead to greater performance and competitive advantage. Due to the discussion above, that the relationship and governance process between the VC and the entrepreneur is complex and crucial for firm performance, there should be a great need for the VCs to have good governance strategies for how to develop the firm.

Even if numerous studies of venture capital investments have been carried out, the structure of which the VC firms monitor and control their portfolio investments seem to be somewhat untapped territory. A large amount of research has focused on how entrepreneurs attract financing, the return of PE-funds and the impact of VC investments. Research regarding how VC investors influence the corporate governance strategy and how their involvement affect the professionalization in the portfolio companies seem to be a missing part of the puzzle. We have also found a gap in the existing theories when it comes to comparing governmental and private VCs governance strategies. With their different backgrounds and incentives, there

[1] Moral hazard is when you enter an agreement with one part who do not have good faith, misguide you with incorrect information or who has incentive to take on unusual high risk in order to generate profits. (Culp 2006)
[2] Adverse selection is when one part has more information than the other which could affect the outcome of an agreement. (Culp 2006)
[3] The hold-up problem is in economic terms, when two parties would benefit from a collaboration but where one of the parties choose not to because the other one would get increasing power which would affect them negatively. (Berk & DeMarzo 2007)

could be an interesting dissimilarity in how they work with their partners. Since a VC needs to be confident in their investment in order to invest (Cable & Shane, 1997; Kaplan & Schoar, 2003) the structure of which they monitor and control the investment, i.e. their corporate governance strategy, is of high importance. Further, a well established corporate governance system can decrease the inherent risk in an organization (Tricker, 2009) and a decreased risk will decrease the required return of the investment (Koller et al., 2010).

The VC industry has a large importance in the Swedish business economy, and has been growing tremendously the last decades. SVCA, the Swedish VC association explains that in 1985, the Swedish VCs held 1,5 billion SEK in assets, which in august 2010 had grown up to 482 billion SEK (SVCA, 2011). The VC financed companies in Sweden account for 8% of the total Swedish GDP is therefore one of the leading countries within this. However, even if the Swedish VC industry is large and influential, an increasing number of people have started to argue for more VC-firms, especially within seed investments. Since seed investments are the hardest to get a substantial return from, politicians have started to increase the attention to governmental VC firms. The focus of the governmental VC firms tends to have more of a social focus than financial compared to the private. Private and governmental VC-firms sometimes have substantially different required return on their investment. It is not uncommon for private firms to demand an IRR of 20-25%. Industrifonden, a Swedish governmental VC firm, is on the opposite scale and has a target to reach returns of 0%+inflation. Clearly, the difference in required return could lead to large organizational differences and also differences in risk profile. The risk profile is, as previously mentioned, an important factor when it comes to deciding upon a corporate governance strategy. Hence, chances are that private and governmental VC firms have large discrepancies in their corporate governance strategies.

## 1.3 Important Definitions

***Venture Capital***

When mentioning Venture Capital, we follow the European definition which means early stage financing. There are a few distinctive characters in a venture capital investment; equity form of financing, limited time-horizon, active participation from venture capitalists that through the governance work develop the firm and reduce the investment risk, and a focus on growth companies. (Gompers & Lerner, 2001).

***Corporate Governance***

In this thesis, we follow the OECD (2004) definition for Corporate Governance; *"…a set of relationships between a company's board, its shareholders and other stakeholders. It also provides the structure through which the objectives of the company are set, and the means of attaining those objectives, and monitoring performance, are determined."* (OECD, Principles of Corporate Governance, p.11)

***Corporate Governance Strategy***

Corporate governance strategy refers to the process of which investors apply corporate governance in a corporation.

***Means of Corporate Governance***

The means of Corporate Governance is the channels of which corporate governance is applied in an organization.

## 1.4 Purpose

The purpose of this thesis is to describe and compare the corporate governance strategies of Swedish private and governmental venture capital providers and through what means they apply it.

We want to investigate whether private and governmental VC investors have any discrepancies in their corporate governance strategies and if this can be explained by a difference in target regarding their financial and social returns from investments.

## 1.5 Outline

We will structure our study like this; after this introduction, the next chapter will be about the design and method of our study. In chapter 3 we will present theories and studies which examine the way VCs work with governance, which will be used when we create our framework. In chapter 4 present the empirical study. In chapter 5 and 6 we analyze our data, draw conclusion and suggest topic for further research.

# 2. Method

*The method chapter begins with an explanation of the research type that been chosen to answer our purpose. We will also discuss how we collect our data and the rational behind the choices made. Finally will discuss how we are going to analyze our empirical data and discuss validity and reliability of the chosen method.*

## 2.1 Research type

In *Research methods for business students,* Saunders, Lewis and Thornhill (2006) discuss three research methods which you can use to generate outcomes that you analyze and draw conclusion from, in a way to fulfill your purpose. A study can either be of exploratory, descriptive or explanatory. Exploratory studies seek to understand the nature of a problem, what is happening and to test it to gain new insights. A descriptive study wants to give a clear picture of the profile of persons, events or situations (Saunders, 2006). The important factor here is to understand what, when and who but not the reasons behind the events. Explanatory studies have the intention of giving a causal relationship between different variables and to explain why certain outcomes occur (Saunders, 2006). Our study is a mix of these purposes; we want to gather information about how VCs work with governance and how they develop their strategies, and also comparing these strategies between different VCs, trying to find patterns if ownership structure affects the governance work.

The research can be made by three different approaches; inductive, deductive and abductive. An inductive approach investigates a situation and from that tries to conclude it in general assumptions or theories. A deductive approach, on the other hand, is research that builds on established ideas and theories and moves towards a situation (Anderson, 2004). The approached used in this thesis will be made using somewhat of a deductive approach, since it will be build upon research made by Beuselinck, Manigart, & Cauwenberge, (2007). Our research will follow the same structure which is; (1) *Board of Directors*; (2) *Interim reporting*, (3) *Audit Certification*, (4) *Ad hoc communication.* The research of Beuselinck et al. (2007) will be the basis for the framework for our research. However, we will try to extend the framework by adding additional research of interest. This is made to extend and evolve the framework. The empirical material collected will then test and further evolve the theory. We will, after building the framework stronger by adding further research, test it with the empirical data. Hence, this is not a deductive method, but rather a method called abduction. Abduction has characteristics of both inductive and deductive methods, but is not a mix of the

two since it adds new elements (Alverson & Sköldberg, 2009). Abduction is going from an existing theory, tests it with empirical data and finally tries to develop and evolve the existing theory. The research process therefore alternates between theory and empirical facts and then reinterprets those (Alverson & Sköldberg, 2009). Alverson and Sköldberg (2009) explain that abduction is *"probably the method used in real practice in many case study based research processes*" (Alverson & Sköldberg, (2009), p.4).

There are many reasons why we chose to follow the same structure as Beuselinck et al. (2007). First, this is the only previously conducted research we found that have a similar focus as we have. They, just as us, focus on how VCs apply Corporate Governance within an organization and the only difference is the fact that we also have a purpose to compare private and governmental VCs. Secondly, we agree with the authors that these are the most important means of applying corporate governance within an organization. Further, the use of these means is easy to restructure and change within an organization trough out the time of the investment which makes them interesting to analyze and a key component of the corporate governance strategy. Finally, we have not found any opposing articles or article that brings forward other important means of corporate governance. One mean of corporate governance can be added, which is management compensation. However, in VC investments, the management is most of the times already owners of the venture, which makes it a less important mean of governance. Yet instead, this mean of governance is of larger importance with PE firms since they often purchase the shares from the founders. Since our purpose of this thesis is to investigate the corporate governance strategy of VC firms and not PE, we have decided not to focus on this mean.

Finally, this descriptive and explanatory abductive study will be performed using case studies. According to Yin (2003) case studies are *"the preferred strategy when "how" or "why" questions are being posed, when the investigator has little control over the events, and when the focus is on a contemporary phenomenon within some real life context*" (Yin, 2003 p. 1). However, the findings will be presented in an atypical manner. We will not present the cases, its background and its underlying problems as commonly made with case studies. We will instead present only the findings from the interviews in a summarized manner, in order for us to conduct the analysis in a more structured approach. Further, presenting a long presentation of the cases would not help the thesis. Instead, it would confuse the reader and could mislead

the conclusion since other aspects than the ones we aim to investigate might be taken into account.

## 2.2 Data collection

In this section we will discuss how we collect our data, both the primary- and secondary. We will argue about the methods used when searching for existing theories, but also the methods applied when generating our own theory and knowledge. After reading this section, the reader will have a clear understanding of how and why we have made certain decisions in order to increase the quality of the study.

### 2.2.1 Secondary data collection

Secondary data is data collected by another part with a specific purpose often different from one's own (Saunders et al., 2006). This kind of data can be useful since it can give access large samples. By using secondary data, the demand for time and money is reduced.

We will use secondary data as a way to build up an understanding of our subject and the need for this study. The secondary data, often articles and books, is the foundation from where we develop our own study and research models, and which will be an important tool for analyzing our primary empirical data. When we gathered the existing secondary data we searched for theories that explained the two topics, corporate governance and venture capital, but of course also the way governance has been executed in the venture capital industry. Due to the limited amount of research regarding governance in governmental versus private VCs, we had a tougher time gathering that data. But throughout the search for data, we have very carefully considered if the studies were valid for our study and its purpose. The importance of presenting data which easily can be compared and that is well suited for our investigation should not be underestimated. The databases used when collecting the secondary data has been LibHub, Google Scholar and Business Source Premier.

### 2.2.2 Primary qualitative data collection

Saunders (2006) explains that primary data is the data that is gathered for a certain research project. As previously explained, our data will be gathered through interviews conducted with representatives from VC companies. Qualitative data is the "*kind of research that produces findings not arrived at means of statistical procedures or means of quantification*" (Strauss & Corbin, 1990, p.17). Qualitative data collection can, according to Patton (1990), be made

using three different methods: in-depth, open-ended interviews; direct observation; and written documents. In-depth interviews are data collection by asking and discussing different topics. It is a two way communication method that lifts important topics and analyses and scrutinizes them it a thorough manner (Patton, 1990). The data collected consist of "*quotations about their experiences, opinions, feelings, and knowledge*" (Patton, 1990, p.10). Direct observations provide data from following and screening a certain object without interference (Huberman & Miles, 1994). The data consists of the description of "*activities, behavior, actions, and the full range of interpersonal interactions and organizational processes that are part of observable human experience"* (Patton, 1990, p.10). Written documents are a qualitative method that yields written responses through numerous media such as memoranda, personal diaries and open-ended responses to questionnaires (Patton, 1990).

For us to get accurate information and data that gives us a solid foundation for analysis, we have decided to use in-depth interviews. The reason is that even if a direct observation method can give deep and reliable data, the method is too time and resource consuming. Further, to be able to thoroughly scrutinize and enter deeply into our topics, we see interviews as the alternative that gives the deepest data considering the limited amount of time available.

#### 2.2.2.1 Type of interview

There are diverse methods to conduct interviews. Researchers has to decide whether the interviews should be done in group, so called focus groups, or one-to-one and also what degree of structure the interview will have (Easterby-Smith, Thorpe & Lowe, 2002). Focus group have some positive sides, such as gaining multiple responses and therefore more data on less time spent compared to one-to-one interviews and the so called snowballing effect where participants start to build on each other responses (Patton, 1990). However, Patton (1990) explains that social pressure can make the respondents hold back on their actual opinions and a polarization effect on the people's attitudes can occur. One-to-one interviews are a suitable method to eliminate these issues and are therefore the choice of method for us. Further, we see one-to-one interviews as a more suitable method to spot the potential differences between the governmental and private VCs since we then more easily can zoom into smaller details.

#### 2.2.2.2 Degree of structure of interview

Patton (1990) explains that interviews can be held using three different approaches; (1) *the informal conversational interview*; (2) *the general interview approach* and (3) *the standardized open-ended approach. The informal conversational interview* is based upon an unstructured spontaneous interaction, where the interviewee sometimes does not even realize that an interview is taking place (Patton, 1990). The conversation is build upon maximum flexibility and the questions asked are not predetermined. The data gathered from these interviews differ from each of person interviewed, which leads to that more interviews need to be held in order for them to cover and enter deeply into all areas of interest. The data is also more difficult to analyze (Patton, 1990). *The general interview approach* is an interview process that involves an outline of subjects that need to be explored. The subjects do not need to be taken in any particular order and the exact phrasing is not decided in advance. The data becomes more structured than when using an informal conversation interview and all necessary topics are covered. However, there is still a risk that important topics receives too little attention and that, since the questions might be formulized different in each interview, some answers might suffer from interviewer effect and biases (Patton, 1990). *The standardized open-ended approach* consists of carefully formulized and thought through open-ended questions that are asked in a predefined order. This method of interviews leads to an increased comparability of data and ensures that all necessary topics are covered. Further, it reduces the interviewer effect and biases (Patton, 1990). However, the negative aspects are that it limits the flexibility during the interview and that the standardized wording might limit the naturalness and relevance of the questions.

Since the data will be extracted from a limited number of interviews and certain topics need to be scrutinized and covered thoroughly, the best choice for us is to have *standardized open-ended approach* when it comes to our interview. This allows us to ensure that all important topics are covered in an adequate manner, so that the data received will be enough to provide for a satisfying analysis.

When using the *standardized open-ended approach* great focus needs to lie upon the formulization of the questions. Since all the interviews are held the same manner, the questions need to be formulized so they could be asked without interviewee biases and without room for respondent interpretation. However, the structure and formulization of the

questions are not the only choice that needs to be made, also the kind of questions asked needs to be dealt with (Patton, 1990). Patton (1990) explains that there are six kinds of questions that can be asked; (1) *experience/behavior questions*; (2) *opinion/values questions*; (3) *feeling questions*; (4) *knowledge questions*; (5) *sensory questions*; (6) *background/demographic questions*. E*xperience/behavior questions* are questions that focus on what a person does or has done. These questions' center of attention are descriptions of experiences, behaviors, and activities. *Opinion/values questions* try to extract opinions and what people think about certain issues. These questions tell us about people's values, desires and intentions. F*eeling questions* have an intention to make the respondents to describe and explain their feelings and mind-sets regarding certain issues. This is not the same as describing opinions, since emotions do not need to be rational. *Knowledge questions* on the other hand, are used to find out the level of knowledge that the respondents have regarding certain issues. These questions can be used to investigate the level of knowledge the respondents have regarding certain specific subjects, and by this eliminate misunderstandings or misinterpretations. *Sensory questions* are questions about sensatory apparatus and try to make the respondents describe their feeling and stimuli regarding subjects. Finally, *background/demographic questions* are asked to indentify characteristics of the people being interviewed which can be used to group the responses. These questions can be regarding occupation, education or likewise that describes the situation of the respondents. However, *background/demographic questions* can be hazardous to use in too large of extent since it can make the respondents believe that they can be identified to their responses and might therefore make them less willing to give their actual opinions. These uncertainties can be eliminated by the interviewers discussing this with the interviewee before the actual interview (Patton, 1990).

Our interviews will be held using a majority or *experience/behavior questions* where the interviewees are asked to describe and explain how they use and work with certain corporate governance techniques. We will also use some *opinion/values questions* to investigate their view regarding corporate governance. Finally, in order to be able to make the most of the data, we will also ask *knowledge questions* and *background/demographic questions* to be able to eliminate interpretations and to group and separate answers.

The themes during the interviews will follow the method used by Beuselinck et al. (2007) which is; (1) *Board of Directors*; (2) *Interim reporting*, (3) *Audit Certification*, (4) *Ad hoc*

*communication.* We will also ask general questions to give us a general idea of their opinions regarding corporate governance and also to see if their definition corresponds well to ours. Finally, we will ask descriptive questions to gain extended data and to be able to group the data from the different traits of the VC firms, such as invested capital, governmental or private, employees, years in the industry and number of investments.

#### 2.2.2.3 Interview procedure and process

The interviews are scheduled to take one to one and a half hour, and are taken place at the offices of the VC firms. The interviewees are provided with the questions before the interview so they can prepare and formulate their answers better. We were both present in every interview so no data is missed. Further, the interviews are, after approval of the interviewees, recorded on tape. The interviews are held in Swedish in order to make the interviewees more comfortable and therefore able to express themselves more accurately. The interviews are transcribed afterwards and quotes are translated if inserted in the thesis.

The interviews took place in the VCs offices or conference rooms, and took about an hour to perform. All interviews were made between 27$^{th}$ of april – 3$^{rd}$ of may.

#### 2.2.2.4 Interviewees

For us, the focus when gathering the interviewees is not to establish a representative sample, yet to get interviews with suitable characteristics for case studies. We have interviewed two private and three governmental VCs. The interviewees are contacted via telephone and e-mail, found both within our social contact net, and also via internet and the Swedish VC organization, SVCA.

In order to be classified as a governmental, the VC firms need to have a majority of the financial capital provided by the government and to have the target goals specified by governmentally tied people. Private VC firms have a majority of the financial capital provided by private institutions or people, and a nomination committee and board of directors assigned by these. Our target was to only interview VC firms, and not business angles, business angle consortiums and PE firms.

Finally, we only interviewed investment managers in the VC firms, since these are the ones who work the most with corporate governance and therefore should be the ones who have the deepest knowledge and experience within the area.

We will present the interviewees as G1, G2, G3, P1, P2 which stands for;
G1: Governmental VC number 1
G2: Governmental VC number 2
G3: Governmental VC number 3
P1: Private VC number 1
P2: Private VC number 2

We will not present the name of neither the VC firms nor the investment managers we interviewed. This is because we do not feel that it ads any value to the study, and might be a sensitive matter for the interviewees.

### 2.2.3 Building the research framework

As previously mentioned, the framework of our research will be based upon the research by Beuselinck et al. (2007) will be the basis for the framework for our research. However, we will try to extend the framework by adding additional research of interest. This is made to extend and evolve the framework, and further ensure the reliability of the method. We chose this framework since it was the only study we could find that had a similar focus as the one we have. The framework will then be tested using the empirical data to see whether it is applicable and therefore reliable.

The framework will build on the four means of which VC firms can apply governance; (1) *Board of Directors*; (2) *Interim reporting*, (3) *Audit Certification*, (4) *Ad hoc communication.* These four means will be extended and explained as much as possible with additional research and theories.

## 2.3 Analysis of Empirical Material

When conducting the analysis of the empirical material, the critical issue is to be able to draw conclusions and extract meanings that are valid, repeatable and right (Miles & Huberman, 1994). Miles and Huberman (1994) present in their book *Qualitative Data Analysis* multiple steps to generate meaning of the data. However, only a few of them apply to a case study

setting. They are *noting patterns, themes* and *seeing plausibility.* Yin (2003) presents the final step in this which is e*xplanation building.*

*Noting patterns, themes*

The human mind has, according to Miles and Huberman (1994) a way to find and sort patterns in a simplified manner in order to draw its own conclusions. To side step this, analysis must be made by assigning and analyzing the data gathered and by doing so, try to spot patterns in as objective manner as possible. These patterns are then analyzed using a pattern-matching logic to see how these patterns match and connect to the purpose of the analysis (Yin, 2003).

*Seeing plausibility*

When seeing patterns in the analysis, the question whether it is plausible needs to be asked (Miles & Huberman, 1994). Even if this might be rather non scientific and more based upon feelings, studies have shown that the human mind is fully capable to draw conclusions about plausibility in a verified way. Hence, seeing plausibility is a good early step in conducting analysis (Miles & Huberman, 1994).

*Explanation building*

The final goal is to analyze the data by explaining the cases and try to answer why the phenomenon is the way it is (Yin, 2003). The goal here is not to conclude a whole study or to generalize a complete area, but to increase the knowledge and to develop ideas for further studies (Yin, 2003).

We will, when conducting our analysis try to follow this structure; *noting patterns, themes, seeing plausibility* & e*xplanation building.* Further, Yin (2003) also presents four important principles that we will have in mind when analyzing the data. They are; (1) Show that you attended all evidence, (2) address, if possible, all major rival interpretations, (3) address the most significant aspect of the study and (4) use the prior expertise in your case study, i.e. connect it to the theories presented.

Finally, after conducting the analysis of the empirical material, we will try to analyze if our research framework is applicable to all VC firms and therefore a suitable method to use for analyzing the corporate governance strategies of VC firms. After the analysis we will try to

come up with improvements to the framework so it can be developed into a more suitable model for analysis.

## 2.4 Trustworthiness of Chosen Method

*"All fieldwork done by a single field-worker invites the question, why should we believe it?"* (Maxwell, J.A. 2005, p.106)

The trustworthiness of the data assessed by interviews can be analyzed and scrutinized by using three variables; reliability, validity and generalization (Saunders et al., 2009). In order for the data gathered to be reliable, the process of the conducting the research must be clearly stated so it can be replicated in the future (Yin, 2003). Further, the result gathered must be the same, and not depending on other factors. This can be compared with a scale, the in order for the scale to be reliable; it must show the same result each time you step on it (within a short period of time).

Validity refers to the extent to which the researcher gains appropriate knowledge and take part of the participants experiences (Saunders et al., 2006). If we once again compare this to a scale, in order for the scale to be valid, it must show your correct weight. Hence, if a scale is both reliable and valid, it must show the right weight each time you step on it.

Maxwell (2005) argues that validity is a goal rather than a product and the extent of it depends on the connection of your conclusion to reality. Maxwell (2005) also argues that validity is not something that you can take for granted or prove, and that there is no method which can capture the full potential of validity. I.e., instead of focus on the outcome of your investigation, you should focus on how you develop and collect your data in a manner which give you the opportunity to generate results which is reliable. Throughout our study, both during the process of gathering primary- and secondary data, we will closely consider if our strategies gives us the most valid material to analyze. We aim to dig deeper and get an understanding of how venture capital firms develop their governance strategy and compare if governmental VCs operate different from private. A qualitative method is according to us a factor which increases the validity and provides us with accurate data.

Maxwell (2005) also presents two main threats to validity in qualitative studies, researcher bias and reactivity. The first of them implies when researcher consciously chose to involve

data which stands out or confirm their intentions. Reactivity is when the interviewers affect the respondent during the interview with the result that the answers do not reflect the reality or is biased. These two threats for the validity of our study is of course something we have considered, both during the collection of secondary data, but also when we will carry through our interviews. We think that we have presented an extensive and fair picture of existing studies without picking out extraordinary or supporting investigations. The concept of reactivity is more complex due to the interaction between the interviewer and the respondent. At the same time as we are going to try to be involved and interact with our counterpart, important task will be to ask open question without directing towards specific answers or discussions. Our expectation is that the respondents will contribute with honest and interesting answers about their governance strategy, and that we will get the opportunity to compare and draw conclusions between different VCs.

The term generalization refers to if the findings can be applicable to other research settings in this study and other organizations. Hence, generalization defines how the research describes the reality (Yin, 2003). Qualitative research using case studies cannot give generalization about entire phenomenon (Saunders et al., 2006). However, there are two forms of generalization; empirical and theoretical. Empirical generalizations come from analysis of empirical data where focus lies upon the population of the sample and if it is statistically representative (Mason, 2002). Theoretical generalization instead aims to draw conclusions regarding the theories made and if they are applicable to all similar situations, and therefore considered general. We attempt to by using abduction approach and therefore also come up with a framework that can be applicable to all VC firms. Hence even if the purpose of this thesis is not to obtain a definite conclusion on how all Swedish VC firms' corporate governance strategies look like, it might be generalizable in a theoretical manner.

## 2.5 Criticism to chosen method

Since this thesis is written during a limited period of time, we believe that this method is a suitable way of conducting the research. Believe that the findings can help develop the existing research and theories, and therefore help the understanding of the area.

However, if we would have more time and resources, the method of this thesis could have been perfected. First of all, increasing the sample size would help the validity of the findings and also provide a larger basis for research. Further, not only interviewing more VCs, we

could have interviewed more VCs from more regions. This could given an extra outlook on the area, namely if the corporate governance strategies differed between the regions.

Finally, if we would have more time, we would also have interviewed some of the portfolio companies. By doing so, we could have seem if there was any differences between what the VCs said that they were doing, and what they actually did. That would give us an extra observation which could reduce some of the interviewee biases.

# 3. Theory

*In this chapter we will present theories and studies concerning corporate governance in the VC industry and differences between governmental and private VCs. This will leads us to our framework which will be the used when analyzing our empiric data.*

## 3.1 Theoretical background

Here we present the basics of venture capital and corporate governance in order to clarify the topics for the reader.

### 3.1.1 Venture Capital

Venture capital is a concept that has been defined in different ways depending on investment stages and regions, but generally VC is equity or equity-related financing form that invests in growth businesses with a limited time-horizon and that also contains non-financial support (Kleinschmidt, 2007). The definition of VC in Europe and in the U.S. differs in the sense that in Europe, early stage financing is viewed as venture capital and buy-outs is considered to be private equity. In the U.S. the two financing stages are seen as either venture capital or private equity (Kleinschmidt, 2007; Sahlman, 1990). There are a few distinctive characters in a venture capital investment; the equity form of financing, limited time-horizon between 2-10 years, active participation from venture capitalists that through the governance work develop the firm and reduce the investment risk, and a focus on growth companies. These characteristics comes from the nature of the business, due to the high risk of investing in young inexperienced managers with a product that often is intangible and in a market that is very changeable, the VC has incentives to decrease the risk with the actions mentioned above (Gompers & Lerner, 2001). A venture capital investment contains both financial and social goals, the financial objectives are evident and a VC often demands a high return on their investment due to the high risk. The social objectives of a VC investment are more complex and are often more important for the governmental VCs. The goals are for example about creation of new jobs, increasing wealth for women and minorities, and urban and regional development (Rubin 2009; Davidsson et al., 1997).

The funds raised by the venture capitalists come from different sources which consists of mainly five types of investors; institutions, public authorities, companies, private individuals and fund-to-fund. Out of these, institutional investors are the single biggest source of funds

aimed to invest in small growth businesses (Kleinschmidt 2007). There are also numerous stages in which a VC can invest their money starting from the earliest stage seed financing, further on to start-up, expansion, bridge-financing and at the end of the spectrum management buyout or IPO. Timing is important when it comes to investing but there are other important factors that the VCs consider when deciding which entrepreneur they will collaborate with. These are for example personality of the managers, characteristics of the market and of the product, financial plans and competence and experience of the managers (Macmillan et al., 1987; Zacharkis & Shepherd, 2005).

The history of the venture capital industry is pretty short, starting after the Second World War in USA. It was not until the late 70's or beginning of the 80's that the venture capital industry grew in size, mainly due to legal reforms (Kleinschmidt 2007). The industry is characterized by cyclical periods in which the amount of invested capital shifts. In the 1980s the amount invested in USA decreased because of lower return on previous investments which began to increase in the 90's when the market for IPOs expanded (Gompers & Lerner 2001). Under the internet boom the market for venture capital reached new levels of $103 billion invested. In Europe, the venture capital market developed decades later than its counterpart in USA, but during the years 1995-2000, the amount invested grew from €542 million to €4451 million (Kleinschmidt 2007).

### 3.1.2 Corporate Governance

Corporate governance is defined by OECD (2004) as

*"…a set of relationships between a company's board, its shareholders and other stakeholders. It also provides the structure through which the objectives of the company are set, and the means of attaining those objectives, and monitoring performance, are determined."* (OECD, Principles of Corporate Governance, p.11)

This means, that corporate governance stretches further than the board composition and the connection between management and financial providers. As mentioned in the introduction, investors need to have confidence in a business in order to invest in it. This confidence does not only come from financial statements (Tricker, 2009). They only reflect the past and large amount of the value of an investment comes from a company's future value creation. Further,

the large corporate scandals like Enron and WorldCom with fraudulent reporting have proved that the financial statements in themselves are not enough to induce confidence among investors. All of this has increased the importance of a good corporate governance strategy (Tricker, 2009). Schleifer and Vishny (1997) explain that the main objective for corporate governance is to deal with the suppliers of finance to assure that the investors get a return on their investments. Other explanations can be broader, such as corporate governance as the exercise of control over corporate entities (Tricker, 2009) or dealing with the issues that arrive from separation of ownership and control (La Porta et al. 1999).

Mallin (2010) explain that corporate governance is a rather new area, and is affected by theorists is multiple of areas; finance, economics, accounting, management and organizational behavior. However, one main position seems to hold the definitions and explanations together; it is about ensuring stability and providing trust to investors that their investment is handled in a professional way.

## 3.2 Theoretical Framework

In this section we will further build the Beuselinck et al. (2007) framework to construct our framework for the research conducted.

### 3.2.1 Governmental- versus Private VCs

The target and goals that governmental- and private VC firms haves differ a lot. The target of governmental VC firms are more on social returns rather than financial, while private normally seem to have solely financial targets (Rubin, 2009; Manigart, De Waele, Wright, & Robbie, 2002; Cumming, 2010). UK studies have shown that IRR targets of private VC firms have a benchmark or 30%, but that target returns vary across countries (Cummings, 2010). Manigart (2002) found that U.S. based private VC firms have a higher target rate of return than European VC firms, but that the range seems to be in between 15-30%. The private VC firms invest money from investors whose major objective seem to be to ensure a high return on investment so the target return of the VC firms are high in case one of the investments goes bad (Cummings, 2010; Manigart, 2002).

Davidsson, Lindmark and Olofsson (1998) concluded that VCs are an importance source of job creation in small firms. This is one of the reasons why governments invest in VC firms.

The focus is more on social returns rather than financial. Social returns include economic development rural areas, creation of high-quality jobs, and increasing wealth for women and minorities and creation of products that benefit society (Rubin, 2009). Governmental VC firms have a much lover required returns, many has as a goal to keep the fond at the same level, giving it a required return of 0% plus inflation (Plagge, 2006). Manigart (2002) explains that governmental VC firms "*may emphasize employment creation in a certain area or environmental-friendly investments, rather than purely financial concerns*" (Manigart, 2002 p. 294). Plagge (2006) explains that commercialization of intellectual property is very risky and takes a long time. Private VC firms would not generate enough return on such an investment to please its investors, and therefore it is easy to make a strong case for governmental VC firms with a lower or non existing required return.

Fischer (1988) further examined the role of the governments when they serve as catalysts for social benefits and for the development of many small business sectors and high-tech innovations. According to this study, governmental VCs work with the orthodox economic philosophy that they are the one that should get involved with the private markets when failures or imperfections occur. The result from the study shows that many governmental VC firms might operate successfully but compared to the size of the investments, the author concluded that the contribution to the technology-oriented sectors is not going to be substantial. One reason for this could be the pressure to present good social indicators like new job generated, instead of the most important factor which is generating money to the business. The number of new jobs created is according to Fisher (1988) not a good signal of the contribution, focus should be on the quality and sustainability of the jobs and the overall impact on the environmental issues cause be the VC.

This thought by Fisher (1988), that governmental VCs steps in and gets involved when there is imperfections in the market, gets support from Jeng and Wells (2000) who concludes that governments play an important role in the venture capital industry by investing in entrepreneurs that most definitely not would be able to obtain financing from a private source. The authors behind this study also find that governmental VCs were less sensitive than private VCs in making exits. When considering early stage financing, the difference in sensitivity to IPOs between the governmental VCs and the private VCs, decreases by approximately half of the size.

Lerner (1999) discussed the Small Business Innovation Research program in the U.S. which was a large government program created with the goal to maximize the wealth of small business firms. The firms that got the awards from the government had a more positive trend in employment and sales growth after the appointment. However the size of the award was not correlated with performance suggesting that governments should invest in many firms with smaller amount than a few big investments. A study by Beuselinck, Deloof, & Manigart, (2004) showed that governmental VC firms had lower degree of earnings conservatism. Earnings conservatism means the degree which the earnings more timely reflect the losses than gains in a specific year. This means that private investors are more professional when it comes to monitoring their investments. Bottazzi et al. (2008) found that private VC firms are more likely to increase the contact with their counterpart than for example governmental VCs.

### 3.2.2 Corporate governance in Venture Capital Industry

When creating our framework for the qualitative study, we have been influenced by the study made by Beuselinck et al. (2007). In their "Private equity investors, corporate governance and professionalization" published in "Entrepreneurship and the financial community: starting up and growing new businesses", a book by Clarysse et al. (2007), they have examined the way venture capital investments are controlled and monitored ex post. Beuselinck et al. (2007) found the result by conducting qualitative interviews with 16 VC firms to see how the firms used these. They found that there are four main methods VC investors use for governance; i) the board of directors ii) interim reporting iii) audit certification and vi) ad hoc communication. The study showed that i) the VC firms usually appointed skilled people who rather have experience in an industry specific complexity than financial knowledge. However, even if the VC firms usually independent non executive directors (INED) they might want the directors to some extent intervene with management. Besides from having an INED appointed, ii) VC investors often demand communication through interim reporting where they assess output of a company's performance and financial health. Another mean of monitoring is through iii) internal and external auditing. VCs might appoint external auditors to attest true and fair value of portfolio firm. Ad hoc communication vi) refers to direct communication regarding a certain task. This is used by VC firms to keep an eye on the investment by direct communication with members in management team.

#### 3.2.2.1 Board of Directors

The board of directors (BOD) is the link between the shareholders and managers and hence the foundation for good investor relations and corporate governance (Mallin, 2010). The BOD is responsible for the aim, strategies, plans and policy making of the firm and also monitoring and measurement of the success of those targets (Mallin, 2010). This link is further explained by Tricker (2009) and described in figure 1. This figure describes the main tasks of the BOD, both the perspective; outward and inward looking, and the time aspect; past and present and future.

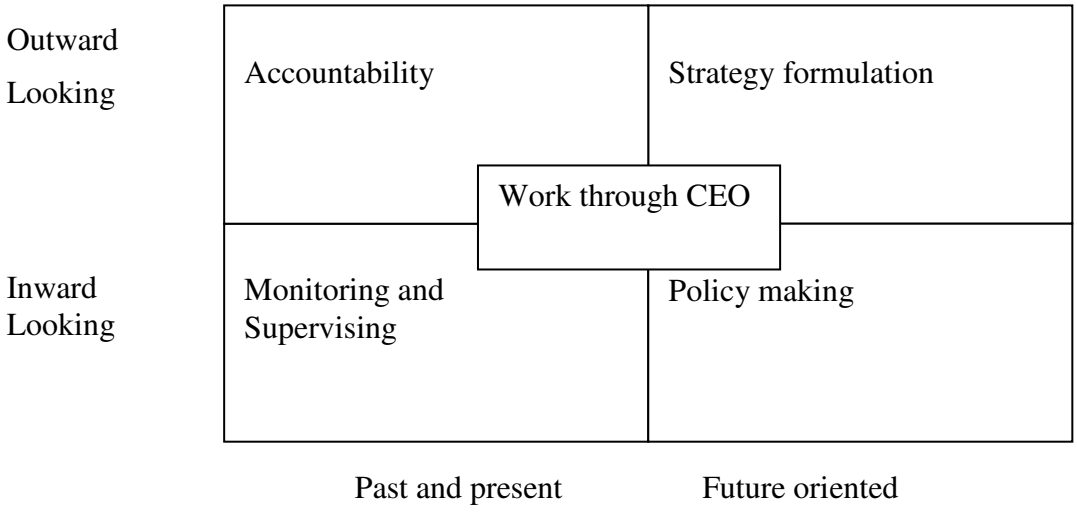


*Figure 1*. Board functions working through management.
*Source: Tricker 2009, p.134*

The model does not recommend the best time spent on each task, yet it should be decided by the BOD when deciding upon the corporate governance strategy (Tricker, 2009).

*Directors*

The directors are appointed by the shareholders at the annual meetings, and can either be managers from inside the company, executive directors, or from outside, non-executive directors (Mallin, 2010). The non-executive directors can also be separated by independent non-executive directors (INED) and connected non-executive directors (CNED). The CNED are somehow tied to the company as a supplier, customer or other stakeholder, while the INED are non-connected.

Van den Berghe and Levrau (2002) argued that since the dot-com crash, there has been a change in mind of many VCs when dealing with the governance work. Today VCs much more often take seats in the boards and are involved with the daily work, especially in high-tech sector. Independence of BOD's is a topic that has been discussed extensively in the new corporate governance codes. In this study the authors found no consensus that the VCs were willing to bring in external knowledge in form of outside directors despite their own people. Van den Berghe and Levrau (2002) reasoned that the delegates from the VC should not count as independence directors due to their relation with the VC and their involvement in the management. The personality of the CEO/entrepreneur was also showed to be a crucial factor for how much time the VC will spend on the firm.

Another study of interest is Rosenstein, Bruno, Bygrave, and Taylor, (1993) which disclosed that beyond the financing contribution from the VCs, a very important task is to serve in the BOD. This study came to the conclusion that high-technology firms have very small boards and that the representatives from the VCs often are in majority. The authors also compared the size of the boards at different stages and found that the boards tend to increase in size as the move along the stage process, but they never reach the size of the public firm boards. Another conclusion drawn from their article was that the contribution from the outside directors was more appreciated in the early stages (seed, start-up and first-stage) and that the entrepreneur thought the most crucial input from the VC was in monitoring financial performance, serving as board members and replacing the CEO. From the qualitative part of the research, the authors found that many of the CEOs were not totally satisfied with the contribution from the outsiders. Potential explanations for this were focus on short-term result, time limitations or expertise.

Hisrich et al. (1998) article found that VC backed firms have more active boards than firms not backed. Active boards are often explained by the characteristics such as outsider representation, small board size and low diversification. Further, firms that are backed up by a VC have a board that is more involved in both strategy formulation and evaluation. Gabrielsson and Huse (2002) also found that VC backed firms have more active boards than non VC-backed. However, the expectations between the VC and the entrepreneur in the roles of the board often differ. Results also reveals that the VC backed firms tends to have larger board with a larger proportion of outside directors and that CEO duality is less common in VC backed firms. Meetings are held more frequently when a VC form is involved and that

VCs have incentives to reduce the information asymmetries. Advices to the board from VC were seen as the most important task. The study by Sheu and Lin (2007) examined in what way the VCs contributes to the portfolio firms. The result reveals that they focus on providing monitoring service at the same time as they allow independence considering board composition and ownership structure. This suggests that investments made by VCs will consist of high degree of information transparence and independent governance structure.

A study made by Hellmann and Puri (2002) found that the founder of a firm in cooperation with a VC is also more likely to be replaced as a CEO in earlier stages. Despite this, the founder often remains within the firm. Khanin et al. (2009) study had more mixed result in the tolerance of the VCs, where some VCs gave the founder extra time to learn how they should exercise the work as a CEO; others replaced the CEO when the firm did not perform well. The founder has to consider this when working as a CEO, or deciding upon who the CEO should be, since for some investors the CEO might be one of the things that decides if they will invest in the firm or not. Higashide and Birley (2002) discussed that conflicts in developing a mutual goal are of more importance than the work towards the goal and the policies. Sapienza, Manigart, and Vermeir (1996) most reliable result in their study was that the VC ranked their strategic role as the most vital assignment followed by interpersonal roles and access to networks.

#### 3.2.2.2 Interim reporting

Interim reporting are reports that provide additional sources of information and often covers fiscal periods shorter than a year (Gibson, 2009). They have the same reporting standards as annual reports but might have different focus and targets. Interim reports can consist of both the usual financial statements such as balance sheet and income statements and ad hoc reporting regarding sales, liquidity or taxes (Gibson, 2009). As previously mentioned, the study made by Rosenstein et al. (1993) found that the entrepreneurs thought that the most crucial input from the VCs was in monitoring financial performance. This study receives support from Sheu and Lin (2007), which revealed that VC firms focus on providing monitoring service to their investments. Interim reporting is a good mean for maintaining that financial monitoring at a good level.

Hisrich et al. (1998) article examined that firms that are backed up by a VC have a board that is more involved in both strategy formulation and evaluation. To help evaluation the board

should have a good reporting system in place. Cable and Shane (1997) argue both the VC and the entrepreneur should increase the level and quality of information transfer. From the entrepreneurs perspective this information sharing is important due to creating a mutual cooperation and understanding between the two parts.

#### 3.2.2.3 Audit certification

Audit certification, or auditing is to report the financial position of a business and trying to detect errors and potential fraud (Kumar & Shama, 2005). Auditing is used to ensure high quality of the financial statements and is therefore an important mean of governance (Shartmann, 2007). Internal auditing systems have been brought forward as a good mean for larger companies to govern the financial performance of a company (Schartmann, 2007). Further, internal auditing systems can also been a good approach for founds and investment companies to use in order to get a fair value of their investments (Schartmann, 2007).

Aside from the study from Beuselinck et al. (2007) which described that VC firms use internal and external auditing to monitor their investments and Schartmann's (2007) description of internal auditing, we have not found any articles describing VC firms reason about auditing. We hope that our case studies can provide further explanation and enlighten the reasoning regarding it as a mean of corporate governance.

#### 3.2.2.4 Ad hoc communication

Van den Berghe and Levrau (2002) concluded that the way of thinking about corporate governance has changed. Instead of just take a place in the board, the VCs today work closely with the entrepreneur in the daily operations, monitoring and formulation strategies. Sapienza and Gupta (1994) found that the VCs were more active in the interaction with the founder if the goal congruence was low, if the founder was less experienced and when the investment was in the early stage of the cycle.

Cable and Shane (1997) study showed that it is important for the VCs to stimulate personal contact between the parties and thereby increasing the information transfer which give opportunities to success. Entrepreneurs consider that the most important contribution from VC is noneconomic, for example network with financial community and business advice, and by investing more in the interaction process a lead to increased payoffs. Higashide and Birley (2002) claimed that problems with the personal chemistry between the VC and the

entrepreneur are negatively correlated with firm performance, and therefore the VCs should try to build a good relationship with the entrepreneurs. Steier (1998) found that factors that can contribute to potential problems in the governance process and in the communication are language, cultural differences and distance.

Another study that reasons about the interaction problems between the parties in a venture is made by Khanin and Turel (2009), which concluded that when the VC and the entrepreneur face cognitive conflicts, it might not be so dramatic due to development of new affecting conflicts. They argue that conflicts either make the relationship stronger between the parties or that it might signal that these two players are better off not collaborating with each other. In line with the previous study, Higashide and Birley (2002) investigating the dynamics of the relationship between the VCs and the entrepreneurs and the authors found that conflicts that depend on different opinions can in the end be something that increases the venture performance.

The Sapienza et al. (1996) study showed some unexpected findings. They found that the VCs interacted more with the CEO when they had more experience in the venture´s industry, and in Europe, when the CEO had greater start-up knowledge. Results also showed that poor performance of the venture did not have any impact on the collaboration and, for example in the Netherlands, the face-to-face interaction had a positive relationship between performance and monitoring. One possible explanation for this unexpected behavior is that the VCs feels more motivated to cooperate with successful counterparts instead of with poor performing firms.

#### 3.2.2.5 Other components of governance by VC firms

In this section we will present studies is a common feature in the previously mentioned categories and can be related to all or most of them.

Steier (1998) found that it is increasingly important today to exercise good governance to be able to create sustainable organizations. In the article he also discuss trust between parties and the difficulty in creating mutual understanding and this is one of the reasons why trust is hard to maintain.

In the study made by Sapienza et al. (1996), they found that VCs do not get more involved with the entrepreneur and the firm when the performance is bad. Other articles suggesting that it is the other way around such as the Fredriksen and Olofsson (1997) study in which they discussed that VCs are comparable to firefighters; they step in and rescue the situation when it becomes critical. Thereby they, through their rescue operations, have an immediate impact on the economic result of the firm. But in the study the authors also concluded that the real impact on the economic development from the influence that the VC had in the cooperation between the parties, should be seen over the long-term horizon. Fredriksen and Olofsson (1997) get support from the articles of Higashide and Birley (2002) and Fredriksen and Klofsten (2001). But due to the fact that VC often increases their involvement when times is worse, Fredriksen and Klofsten (2001) argue that VCs should be viewed as proactive rather than reactive due to the high governance work in the early stages. Ehrlich, De Noble, Moore, and Weaver, (1994) does not agree that VC helps the entrepreneur when they experience problem; instead their respondents reveal that the VC lacked feedback when they needed it the most.

The Van den Berghe and Levrau (2002) study of the high-tech sector showed that there is a desperate need for new corporate governance models. The existing models are not capable of handle the volatility and changing environments that characterize this sector. In the new models one of the key challenges is how to incorporate entrepreneurship and make it be a sustainable part of governance. The role that the VCs play in monitoring and governance of the firms is different from traditional governance of large public firms.

### 3.2.3 Conclusion – Research framework

To summarize, our research framework builds on Beuselinck et al. (2007) and the four different means of corporate governance; (1) *board of directors*, (2) *interim reporting*, (3) *audit certification* and (4) *ad hoc communication*. Within all of these areas, or means of corporate governance, there are multiple items of research. These will be presented here.

*Board of directors*

One area of measurement is the perspective of the work of the board of directors. In line with Tricker (2009) we will try to investigate the VC firms' view regarding the tasks of the board; the perspective; outward and inward looking and the time aspect; past and present and future.

Further, we will try to see in what way the VC contributes to the entrepreneur both in the form of monitoring but also competence sharing, in line with the study by Sheu and Lin (2007).

We want to investigate the willingness of our respondents to take seat in the BOD, number of mandates they have and how they reason when it comes to board composition and board competence complementing. We will compare our result in these questions to Van den Berghe and Levrau (2002), Rosenstein et al. (1993) and Hisrich et al. (1998) studies. Also the Gabrielsson and Huse (2002) study which revealed that VC backed firms have more active boards, larger boards and where CEO/Chairman duality is less common compared to non VC backed firms, will be analyzed and compared with our empirical data. Finally Rosenstein et al. (1993) and Hellman and Puri (2002) findings, that the CEO in a firm backed up by a VCs often gets replaced, is another factor which we will include in our analysis.

*Interim reporting*

We will focus on the findings of Rosenstein et al. (1993) who found that the entrepreneurs thought that the most crucial input from the VCs was in monitoring financial performance. Since interim reporting is a good mean for maintaining that financial monitoring at a good level, we will see in what way this is utilized by the VCs. The importance of reporting in our study when it comes to monitoring the portfolio firms will be evaluated in relation to Sheu and Lin (2007), which revealed that VC firms focus on providing monitoring service to their investments.

*Audit certification*

Shartmann (2007) explained that auditing is used to ensure high quality of the financial statements and is therefore an important mean of governance and we will in line with that research try to see how VCs utilize this in their governance process. Further, as internal auditing systems have been brought forward as a good mean for larger companies to govern the financial performance of a company (Schartmann, 2007), we will also see if this is a part of the governance strategy of VCs.

*Ad hoc communication*

In line with Van den Berghe and Levrau (2002) who concluded that the VCs today work closely with the entrepreneur in the daily operations, monitoring and formulation strategies, we will try to see how they use this ad hoc communication in order to help the entrepreneur in

the process and if this is used in monitoring or competence sharing purposes. Further, as Cable and Shane (1997) study showed, we want study the information transfer since this increased the likelihood of success. We will also compare our findings with the studies made by Sapienza et al. (1996) and Sapienza and Gupta (1994), which investigated the amount of communication and interaction from the VCs due to the CEOs start-up knowledge, different stages, the VCs experience in the industry, the performance of the venture, and the level of goal congruence. In line with the findings of both Higashide and Birley (2002) and Khanin and Turel (2009) we will also try to see how ad hoc communication changes depending on personal chemistry.

*Other theories included in framework*

Studies have shown that conflicts either make the relationship stronger between the parties or that it might signal that these two players are better off not collaborating with each other (Khanin & Turel (2009) and that VCs do not get more involved with the entrepreneur and the firm when the performance is bad (Sapienza , 1996). Other research, such as Fredriksen and Olofsson (1997) and Higashide and Birley (2002), have shown the opposite. This is also a topic of interest and will be included in the research and in all themes. We aim to see if the VCs increase or change the usage of these means depending on how the company performs.

*Governmental vs. Private VC firms*

As previously mentioned, the targets and goals of governmental- and private VC firms differ a lot. The target of governmental VC firms are more social returns rather than financial, while private normally seem to have solely financial targets (Rubin, 2009; Manigart et al., 2002; Cumming, 2010). Private VC firms should therefore have increased focus on sales, cash flow and growth, whilst the governmental VC firms should have more of a monitoring focus to ensure that the social targets are reached. This monitoring probably has more focus on taxes paid and stability. Comparing the two groups will help us see how these differences in targets affect the corporate governance strategy.

# 4. Empirical data

*In this chapter we will present a summary of our collected empirical data. The interviews are compressed and we present the most interesting and relevant findings. If interested of reading our interview question, we refer to the appendix.*

*General questions*

**G1:**
I think that we work with governance as many other VCs; it is through the board of directors and ownership meetings in which we discuss questions regarding ownership and governance. As a rule we always take a seat in the board of directors, but we also have the right to get information from annual meetings. It is important to separate board meetings from annual meetings or meetings were we discuss owner related questions. I think governance is important, not just in the venture capital business but also in general. When you have two separate owners is it important that these have the ability to collaborate and agree in which agenda you are going to follow. Because of the time-limited horizon in the VC industry, the importance of discussing the agenda before you are doing the investment increases.

I do not see that there is a conflict between governance and innovation, quite the reverse.
It is impossible to draw any general conclusions about problems when it comes to governance, every investments has their own life and problems. But sometimes there is problem between the owners and sometimes the problems are that the owners and the management team are not synced in which direction the firm should follow. But there is problem in any firm and it varies in different stages and it is a task that should be solved.
We always sign shareholder agreements which is standardized and these documents includes for example everything that the board is responsible for and which question the board should handle, how transactions will be performed and who elects different representatives. It is only when you experience problems that you use these agreements. I do not think our way of working with governance differ from any other actor in the market.

**G2:**
We work with governance through the board of directors; initially we take seat in the board and stay there for approx 2-3 years. Sometimes we leave the board earlier if we think the board has to be complemented with other competences. And the amount of work with the

firms is correlated with invested capital. We want to invest with other actors as a way to minimize risk. And we also sign shareholder agreements in which all rights and duties are described.

It is extremely important to understand the dynamics of governance in VC investments, especially when the investments are bigger. The persons who operates on the daily basis have an advantage of knowing more about the firm than their potential investors and that is why we, even if we do not have majority, tries to get more power. I choose to split up and discuss innovators as one part and entrepreneurs as the other. And foremost we experience problems with innovators because of the fact that they in most cases not are the right person to lead the firm. They are very good in developing products but they often lack experience from running a firm, they do not know the market and they are not familiar with the selling process. This is often on a personally level and it is important to inform and convince the innovator that they should not have more power than they can handle.

We sign investment agreements when we invest in a firm to make sure that everything is correct. Then we also sign shareholder agreements, articles of association, and last instructions for the board of directors and for the CEO. We as a public actor are not interested in preferred share for example. Then there might differences in the shareholder agreement but the most important thing is that there is driving force and this is why we do not want majority, those who run the firm should have the strongest driving force.

**G3:**

When we make investments we want a seat in the board of directors and due to our relatively big share of the total ownership, and that is often not a problem. In some exceptional cases we have had trouble to get a seat in the board of directors but made the investment anyway. If we do not get a seat in the board of directors we can get an observer post to get the right amount of information about the firm. That is what matters; get the right info and judge the risks and opportunities. Then we often sign shareholder agreements because the companies act is not sufficient due to our position were we often do not have majority. So we often place one of our colleagues in the board just to get the sense of in which phase the firm is in and which competences will be needed in the future. After that we look at the existing competences in the board to make the right decision in who should be new member. Sometimes we use our right to elect a person in the board by using our network and choose a third part to represent

our interest. In other cases we take seat in the board with the intention to get structure in how to run the firm and to implement a professional way of doing things. But as I said, in certain firms we are active in the board for 6 months before we leave our position to a more qualified person. So it is two categories, either we take seat in the board or we choose to another part, and we do this because they often have extraordinary knowledge about the business.

Governance is very important in the VC industry, but there is often a difference in how many owners or VCs that are engaged in an investment, and then the governance power often lies in the actor who has the biggest stake. VCs often want a seat in the board and that because of potential disagreements, but if the owners agree on what competences the board should have, they elect the independent members together. The governance work is important due to the purpose that the VC wants maximum payoff in the shortest possible time. And therefore the firm has to make the right decision and here the VCs have an active role in developing the firm. These firms often have very limited resources which increases the need for interaction with the VC. There is a risk that conflicts may occur between the VC and the entrepreneur, when it happens is often a result from too much pressure from the board that the management should deliver formalities, and that the entrepreneur is the wrong person to work with that kind reporting. In small firms, the management team frequently has very much to do and they have limited resources which makes it tougher for them to deliver for example good reports fast. So from a time perspective, there is a risk that the board sinks the entrepreneur so the VC has to find a more dynamic way of working. Small firms have to update their strategy more often than mature firms.

In most cases we sign shareholder agreements and this because of the ownership structure where many different investors have interest in the same company. We as a VC which invest in the seed stage have other tasks than VCs investing in later stages. In later stages, the work with governance related questions are in most cases about improving the existing work, in our situations, the firms we invest in often not have a good structure and we have to focus on the fundamental parts of governance. The effort in seed stage financing is at least as big as in later stages but the ways to interact differ. When you invest in seed stages, many times the geography is limited but you invest in many different industries. The reverse is true in later stages. So focus in our work is about explaining shareholder agreement and how they should be formulated, how to rise new financing, how to formulated different settlement, how to cooperate.

**P1:**

The way we work with governance differs from firm to firm, we invest in both early stages but we also have multimillion firms. In earlier stages we focus more on communicating with the entrepreneur or other investors, so the daily run of things is very important. This can be explained by less experience by the entrepreneurs in running a firm in these stages, formalities and board meetings get more crucial. And the governance work is really important to develop a relationship between the parties where you have common vision and goal and how to reach it.

We do not see a conflict between innovation and governance in the VC industry, if there is a problem it often depends on the personal relationship between the actors that you disagree in where to focus and how to reach your goal. Sometimes we also feel that the entrepreneurs have difficulties collaborating and when they get money from us, they see it as their money and that they have the freedom to do what they want. That is not the case, we set the framework and then the entrepreneur should adapt to that. When it comes to contractual agreements we always formulate and sign a shareholder agreement. Here we outline our rights, for example complete transparence, the right to elect board members, running view in the firm and so on. Important to inform the entrepreneur so that he/she understand these documents.

I think that our governance strategy is different from many others in that respect that we do not focus so much on formalities. Many of our colleagues have an entrepreneurial background and are more interested in getting the teamwork and business idea to work as planned.

**P2:**

My starting point is that when we invest in a project, the entrepreneur is our partner, colleague and we has to have the same agenda to be able to generate growth. We have other agendas that may differ from the entrepreneurs but the important thing is to agree on a mutual agenda which helps us fulfill our goal. So governance for me is about exercising a mutual governance process.

The governance process is important and because a firm consists of a CEO, a board and the owners, so to be able to run a successful company, the CEO and the board must understand

the owner's agenda and work within their framework. I do not see a conflict between innovation and governance, when problems occurs it is often a result from discrepancies between the ambition to innovate and profitability. That is why you have to be observant in how the innovator or entrepreneur behave, and clearly communicate how we should work in the future. Sometimes there is a disagreement between the owners, sometimes it is between one of the owners and managing directors, but either way our task is to keep the firm going into the right paths and stick to the agenda. We, as many others, sign shareholder agreements together with the entrepreneur which is very standardized with the aim to get the entrepreneur conscious about how we should work together, if he/she thinks it is reasonable, is the conditions something he/she could handle and so on. So these agreements fulfill a more pedagogical task.

What makes us different from other VC firms is according to me that we want to work more closely with our investments. We see them as our colleagues and we do not just sit at our office and demand a couple of reports each month, which is not how we work and it does not stimulate an interaction. Instead due to the vicinity geographically to our entrepreneurs we like to be involved and to use our network when suitable.

*Board of Directors*

**G1:**

We think that the optimal board of directors consists of 5-7 members where we usually appoint 1 member. This size is good because we avoid the situation where there are too many members but also if the boards have fewer than 5 members, the existing member's interest will have too much influence on the work. When you compose a board you have to have a leadership, and it does not have to be the chairman who is the leader, the essential is that there is a leadership who can challenge the CEO and be a support. You can say that there should be competences in the board to take the CEOs role, but it is also important to have a diversified mix of competences dependent on in which stage the firm is in. And when you decide upon the board composition it is always a compromise between the interests from owners, founder and so on and the agreement signed when the investments were done. We think that this process in general is done with a positive attitude in spite of the fact that it is a negotiation process.

The need for different competences in the board differs depending on if we invest in a life science firm or a more technical one, but the importance of the board I should say is the same. Unfortunately, the reality is often that we work more with those firms who struggles than the good ones, much because of the higher workload in low performing firms and especially in legal related problems. But that is life in the VC industry and it is possible that the high performing companies could have better result if this was not true.
We focus on early stage financing, firms that have a prototype and that are in the process of commercializing, along the development we try to find what knowledge the firm is lacking. In these stages, financial competence is often something that is missing and then we complement with that. When the firms grow, the management team becomes more complete and the interaction from the board more rarely.

In many cases we use our internal resources to help our objects but that can be very different, sometimes we choose to elect an external part. But because of we in many cases is investing together with our VCs, every VC cannot have a representative in the board because then the board will lack business competence. In early stage financing, we is often the first external part that comes in and work with an entrepreneur, and therefore we have the intentions in these stages to improve the structure and reporting in the board work. Our investment managers spend approximately 4 hours a week on a firm, and if that person is responsible for 5 companies, the total amount will be 20 hours a week in board related tasks. Every investment has one´s own peculiarity and it is hard to generalize where the need for help is most urgent. When we discover some abnormalities, we try to solve it as quick as possible, that the whole meaning in being a VC to identify risks and solve them. Abnormalities concerning liquidity are one recurrent problem.

As far as I know, none of our investments have the same person as CEO and Chairman of the board, and we try to avoid that. As from the owner's perspective, the duality of this kind does not have any benefits, only for the person who may have these two positions. When we reason about the CEO appointment, we think that an entrepreneur can be suitable as a CEO if he/she has the right competences. The innovator is in most cases not capable of running a firm; but it all depends on the personality and the ability to understand if you have the right toolkit for being a CEO. If the entrepreneur do not have the required skills we appoint an external CEO, but it is an important question for the owner to solve. If we remove the entrepreneur from being a CEO, it often is a result from a conflict between the parties and then we do not have

any motives for keeping that person. These entrepreneurs feel better being responsible for the technical development than dealing with human resource problem for example. It is essential that these people do not feel too much prestige in leaving the CEO position. Also here there is no general theory.

We think that our most valuable contribution to our partners is that we bring in competent capital, and by this we mean that we try to build a structure and routines for reporting, making an agenda for the owners, in short to build a company of a project. Also in a more general perspective we contribute with stability, confidence and long-term engagement. This engagement in the board is something that I think is entirely positive, of course the board members have a personal responsibility, but the work in the board gives us the opportunity to guarantee that the firm is acting correctly and adjust potential deviations. If you ask the entrepreneurs they will probably answer that we contribute with capital and 25-30 years of experience in running firms and knowing the business.

**G2:**

The ideal situation is that the board consists of 4-5 persons. We strive to make the entrepreneurs conscious about the difference between the management team, the CEO, the board and the owners. Important to know the difference and how they should work, for example the optimal case is if the CEO is not a member of the board and that the board does not only consists of owners, we want at least 2 independent members. Otherwise after a couple of financing rounds, the board would consist of only representatives from different owners. We also want a chairman of the board who is independent and have experience of small firm business. Of these 4-5 board members we usually get 1 mandate.

And this view of board composition is a general thing which we try to apply to every firm we invest in, we focus on complementing the board with those competences that is lacking. Younger firms often need external knowledge much because of the limited resources in early stages. But the board work and its importance can differ when comparing different businesses and in what stage the firms belongs to.

We focus our resources to improve our investments the first 2-3 years after our entrance, if they after this period have been incapable in finding new financing, we most definitely will cancel our engagement. According to the classic model you should get ride of the poor

performing firms, but I think that we have a bigger patience than private VCs but it is of course a dependent on which problem the firms is experiencing.

Initially we use our own resources in the board, much due to our overall capacity, but we also try to see where external competences could help our investments so we get the right person at the right place. I think our board members spend approximately 4-6 hours a week on the board tasks but that fluctuate very much depending on how it goes. Under certain conditions they might work 4 hours every day so working in young firms is often more intense than more mature companies, especially for the chairman. When it comes to developing technology and finding a market for the product, it takes much time and resources.

There is no firm in our portfolio that has the same person as CEO and chairman, it would not work. If the entrepreneur also is CEO, the reason for that is that the firm is in the beginning of their journey but after a while he/she will be replaced by someone more experienced. The entrepreneur is in very few cases the right person to lead the company and this is something we communicate to our partners at the start of our collaboration. If experience problem with the entrepreneur, we stop the financing.

I think that our most valuable contribution is that the firms in our portfolio have to gone through our rules and regulations, which makes further collaboration with other investors easier, a kind of due diligence. If I should mention any negative aspect with sitting in the board, it is when we want to leave and stop our collaboration, that´s when it might be problematic. The entrepreneur appreciates us because of our experience, our network and the credibility that we bring to the firm through our interaction.

**G3:**

The boards in our invested firms usually consist of 5-7 members where we have 1 seat. We may also have the right to appoint a deputy member. The board should, in the optimal situation, consist of a diversity of people and knowledge. We analyze what kind of competence the board has in the beginning of our collaboration and then we try to complement with non existing knowledge. For example board members should have experience from the business; otherwise the CEO would have an advantage over the board. But it can also be competence in formulating contracts or in finance. We also think it is

important that the chairman is independent and the owners often come to an agreement about this.

The board work may differ between our firms dependent on in which stage they find themselves in, and what competences they should have. If a firm should go and get listed on a stock exchange, it is important that some board members have experience in listing a firm. I do not think we give priority to and work more with either poor or high performing firms; it is rather a question of where we can add the most value to the firm. This interaction varies from situation to situation but it is very easy to fall into the trap of spending more time on firms that struggle and do not have very good future prospects. When the firms grow and get older the importance of our interaction increases in that sense that we often have increased our exposure, and we then try to focus on the most promising projects. But another perspective on this is that after being involved in a firm for a certain time, the motivation for disposing increases and this takes time to plan.

We do not have a preference of appointing our own staff or someone external, the most essential here is to build the best possible board. But it is obvious that we cannot sit in every board due to limited time and resources but this is analyzed from case to case. When we want to complement the board with external competence we often try to agree on this with the other owners before we invest our money, either verbally or under more formal circumstances. In the situation where we bring in “outsiders”, it is in many cases the position as chairman that we try to find an independent person. But if we are allowed to decide we usually appoint a few other independent members. The chairman of the board spends in most cases approximately 4 hours a week on work related to the board; ordinary board members may spend half of that. It depends on how the firms are performing. Comparing our investments, the ones who take the most of our time is those who experience challenges. Especially challenges concerning financing and the need for new rounds of financing and this often results in many meetings with potential investors which is time consuming. Also problems concerning internal conflicts and patents are very demanding challenges for us to solve.
We have one case where the CEO and the chairman is the same person but this is very rare. If it happens it most definitely have been preceded by removal of the CEO and where the chairman took over for a short period of time. This is not optimal because it destroys the fundamentals of governance between the roles. If the entrepreneur or founder also is the CEO it can have some positive effects, like from a resource perspective, often the entrepreneur is

very involved and interested in the project and you also get away from problem between the founder and the CEO. Despite this, the entrepreneur is rarely suitable as a CEO; they have other skills which are more valuable somewhere else. They often see opportunities where others see threats and this is very good in early stages, but when the organization starts to grow these persons lack the ability to coordinated and manage people and handle the demand for structure and communication. If we remove the entrepreneur from being a CEO, we sometimes want to keep that person in the firm if we feel that he/she can continue to generate value to the firm. Other times we do not want to keep the entrepreneur and then we try to realize this as smooth as possible. But this is a classic example of agreements that we want to discuss and decide upon in the start of the collaboration.

I think we are most valuable to the young start-ups because we have experience in governance and when they need to bring in new financing. Another area where we add value is in structuring the board work and recruiting new board members or CEOs. I cannot say that there are any disadvantages in being active in the board but of course it takes time and resources. But we often take large part of the shares, we have competence and we do not have so many investments which makes it possible for us to be involved in the boards. Our colleagues have a personal responsibility when they sit in the boards but as long as they have the right competence it is often not a problem. Finding the right competences in the board is important, not only to have representatives from the owners. One reason for VCs frequent interaction in the boards is that they feel that they are forced to do that towards their own investors, which gives them money that should be used to help young firms and interact with them. If they do not sit in the board it raise questions about the whole meaning the VC existence. The entrepreneurs agree that we are most valuable in tasks concerning governance and financing.

**P1:**

We prefer to have 5 board members in those firms which we invest in, of two reasons. First of all, it is an uneven number but it also is an appropriate size, not too many not too few. Of these 5 seats, the owners who might be us alone or together with some other VC usually take 3 seats in the board and the other two will be appointed by the entrepreneur. Our 3 members do not have to be someone from our firm; instead it could be an external person that we recruit from our mandate who has some unique skills. When we participate in the process of creating a board, there are according to me three things that matters. It is the personality, the

competence and the professionalism and the ability to understand a business model. And this view of the board is the same for our different investments. Then our interaction with these boards differs depending one their capabilities and performance. We reason that we should be more involved with high performing companies, partly because we want to build attractiveness between us and the entrepreneur, they should like us and that we are there to help them but it also means that they should do their part of the work correctly. Otherwise this attractiveness would disappear. Then we also very carefully study who of these firms and entrepreneurs that have the ability to earn money, who are the ones with excellent future prospects. You as a VC do not build successful firms by rescuing bad performing firms.

When our investments grow and maybe get listed, the job with formalities increases, for example compliance with difference codes and so on. The market expects that you should be a serious player and with that some different work tasks will enclose. We do not have any preference of recruiting internal colleagues into the boards, instead the competence decides who gets our mandate in the boards. During our investments journey from being a project to hopefully a profitable company, the needs for competences differ depending on in which stage they are. We take this under consideration and communicate this to our fellows; you will be here as long as you are the most suitable candidate. After that we will appoint someone else, so we have a very pragmatic attitude to this.

Our representatives spend approximately 2-3 weeks a year on board related tasks. But it can vary depending on the situation. Those objects who take more time and energy than others are where we should build a good personal chemistry and mutual respect between us and the entrepreneur. Building a good team takes time. We never apply the situation where one executive operates as both the CEO and the chairman of the board would never accept it. The entrepreneur is often in the beginning of the stages the CEO of the firm but we have several exceptions from this. In many cases the entrepreneurs are not capable of running a firm, they often are very skilled at the more technical details but not on being the leader. If they do not accept this we would not invest in their idea. When we remove the entrepreneur as CEO we do not have any routines of keeping him/her in the organization, unless the person is very skilled

I think that the most important contribution from us is through knowledge, capital and network. If I should mention some negative aspects of board commitment, I would say that there is a potential threat that the board meetings will only be about owner related question

and that the most crucial questions for the firm remains uncommented. The entrepreneurs often agree on our strength as a VC and where we add most value to the firms.

**P2:**

When we are active in the boards in our investments we believe that either 5 or 7 is an appropriate size. But it does not have to be an uneven number. When we entering a project we always take seat in the board for two reasons, first of all after the screening period we have knowledge about the firm after being involved a while and then it is important to follow the investments and analyze which competences they need along the way, both on management and board level. So our task is to guarantee that the board is as good as possible. So we usually sit in the board during the first year, sometimes longer, and then replace our representatives with outsiders. And this process of complementing with external knowledge is very important and that we bring in a person who has both experience of young start-ups and the ability to develop a project. Our view on the board is not different depending on which businesses we invest in, it is rather a question of which person can contribute the most at different stages. In the beginning the problems are of certain character which change in later stages, therefore switching board members is often vitalizing. Also the performance of the firm affects in what extent we interact with our entrepreneur. Bad performance or problems is something that results in higher workload, and the importance of knowing the entire firm and being able to make the right improvements is crucial in these situations.

When our investments reach a point in time where they are not small anymore, we come to the situation where we have to analyze the leadership within the firm and if we need to make any changes. We discuss this we the CEO in the early stages that we have the intention to make some adjustments along the way depending on the need for the firm. Despite this when the changes are made it is often very hard for the old CEO to accept the thought of leaving the power to someone else, but it has to be done if the firm should have the best possible chances of succeeding. The boards in our investments usually have meetings 5-6/year and at every meeting there is preparation before and after the meeting. But our representatives do much more than just work related to board meetings; they work closely with our entrepreneurs at the daily basis but if I should say a number maybe a couple of hours per week. The amount of work required is higher in early stages where the firm is trying to get a structure about their operations, but also when you are in the process of implementing changes.

We do not have any firms where the CEO and the chairman of the board is the same person, and I do not know anything about this because I have never experienced it. The entrepreneur is very often the CEO in early stages but when the firm expands and the entrepreneur comes further away from the operations, he/she feels more uncomfortable with the role as CEO. Then it is time to make a change. In the normal case we try to keep the entrepreneur in the organization but this require pretty much from the individual to keep their humility and to accept working with a new leader. I think that we add most value to the firms due to our experience and our network, to see where we need to make a change and replace a board member or an executive. The entrepreneurs usually agree on this. I cannot see any drawbacks from being active in the board, it is a prerequisite. Of course every board member has a responsibility to behave according to codes and rules but as long as you know these conditions and feel that you have enough competence, board commitment is only positive.

*Interim reporting*

**G1:**

We demand that the board is provided with the necessary reports in good time before the board meetings. But in addition to the reports needed for the board meetings, we also want to get reports regarding numbers, such as sales, costs and liquidity. This is more when the companies are in a later stage. In research based companies where the process of development takes longer time, we want interim reports and mostly regarding liquidity since that often is the most critical issue. Finally, if we need reports due to certain decisions we need to take, we expect a report that helps us with that decision.

The most common reports are the CEO report, which includes important events, follow-ups of resent decisions and financial reports in the form of basic balance sheets, income statements and liquidity. Further, reports regarding sales, how the prospect list look like, where they are in the sales process in the different markets and how it processes, are common in companies that are in an early expansion phase. In research and technology development companies, the most important rapports are to see if the process is following its plan and meeting its targets. It is important to in time spot if it will diverge from its plan and be able to react to it in time.
When it comes to the reports, much of the difference comes from the difference in management teams in the companies. Some formulate the rapports with bullet points, others

with large essays. It depends much on the complexity within the organization; larger companies have much more structure than smaller.

The objective with the reports is mainly to verify that the company is following their plan, but also to see if there are any issues with the sales process and if the board can help with this in any way. We would not change the usage of rapports if we would have problems with the entrepreneur. It is more important with ad hoc-communication when that happens, so you can spot where the problem is. It is hard to spot the problem by reading behind the lines. It they cannot reach the targets, it is more of a board of directors issue than anything else. We do not have any specific time requirement for rapports. We need to have it in good time before board meetings, so we can make the right decisions. However, in special cases, like when people start to leave the company, we might want a report ASAP. In that way, we might be able to stop the trend.

**G2:**

The minimum standard for rapports is to get interim reports four times a year. But sometimes it can be daily rapports about sales, other times only an e-mail from time to time. The most common rapports are interim reports and information for the board meetings. The balance sheet and most of all the liquidity are important to keep track of. We also demand to have a look at the tax-account, which is very important to us, since we are governmental and state financed.

The reports might change some if the company misses their milestones, which can force them to give monthly updates regarding the process. In that way, we are able to follow the process more closely and help if needed. If we would face problems with the entrepreneur and would not receive the rapports needed, we would probably leave the investment. This is due to trust issues, which to us is very important when making an investment. If that happens, we will exit the investment.

If we want a report, we want it rather quickly, mostly since we have signed agreements that states that we have the right to information. However, we cannot demand it too soon, since that would force them to work too hard with the production of the reports. In some cases, we need a report to be able to make a decision, and if they want us to make up our mind quickly, they also need to gives us the report in time.

**G3:**

Usually, we get some kind of monthly report from the CEO, which can vary in scope and nature. The reports are either an Excel file which contains financial information or one Word file. Sometimes it is combined some do it in power point format, some do it in Word format. And so it tends to be the financial one statement, everyone does not report financial statement each month. We can also receive reports about then on their own products and their launch or quality problems, then something about the organization, like that of any employee or hiring or anything of value. There may be patent issues in some companies it is important.

There are large differences between what is important to report the different companies in early stages. It is often the board must make demands which are the expectations one has usually it is someone or some board members who have understanding.

The usage of reports can change if the company does not meet its targets, but there are often reports on a specific area. Some entrepreneurs find it extremely difficult to report the numbers and such, so you do sometimes then suggests that someone else will write the report such as the CFO.

The time required to produce a report depends on what it is about, about some things one can call and say that you want in an hour, for example to confirm how many employees you were last turn of the month. While other things can be fair to say that developing a plan for you now is establishing a company in China, you will need maybe 2 months.

**P1:**

In a normal situation, we receive reports monthly or quarterly, depending on the company. But then we are talking with the company about 10 times as often, or more frequently. And then I read we have to ensure that what you say is true.

The normal thing to include is all financials, but adjusted to the company. But also regarding the sales process where we need to put enough weight in the commercial work. There are many companies, especially at Ideon, where they develop and develop and develop. And we think that is less interesting, we focus on sales and results.

The uses of reporting depend on many things, such as what stage the company is in and if there are crises. If it is tough times it is the cash balance you want all the time. And payment plans and liquidity reports and so on.

If the company fails to meet targets the firm must decide what to do with the investment, if you sell it or abandon it in some form. When you do not believe that this will not fly it is better to stop in time. If you do not choose to stop you might change the use of reporting and, case by case, try to address the problem. But if we have problems with the entrepreneur, we would probably try to find another, more suitable person for that position instead. When we require a report, we want to have it delivered as soon as possible. The management should have that knowledge and have information available.

**P2:**

When we invest, we first look at their reporting system today, if it is not good today it might be improved. It is very important for us when we invest. We want to have at least quarterly financial statements, but it is also important depending on what stage company is in, in a small start-up development company it is important to keep track of liquidity.

What we want to have reported is individually tailored, liquidity is of course important in any context. Keeping an eye on liquidity is important, we think this is the primary piece of the main report. However, the use of reporting is dependent on the company's situation with what it looks like and where it is at.

The usage of reporting might also change depending on the success of the company. If it falls or it does not meet the plans is a clear need to have a closer follow-up, but once again I am back on liquidity. That is where you notice it first.

If we have any problems with the contractor, we would probably not change the use of reporting. Instead, it affects much the relationship. If it is bigger issues, then is it not enough to require more reports. Then you must sit down with him and say we can not continue this way.

The time required for a report differs, to have a written report on the economics or marketing, but it should be as current as possible. We have no hard rules about it.

*Audit Certification*

**G1:**

The Board normally does not use an audit a lot in other cases than the regulated. We use it to audit the annual reports and sometime we invite the auditor for the annual meetings. Our shareholders' agreement gives us the privilege to appoint our own auditors and give them the right to personally go in and turn around all the papers. But I have never, over 11 years in this position, needed to do so. It is about suspected criminal activities. But we rely on the company's auditors and the audit reports. It is very much in this type of company's discussions with the auditor regarding capitalization of development costs, depreciation and amortization.

We do not use any internal auditing systems, normally the companies we invest in are too small for that to be rational. We have a good feeling about what is reasonable and not reasonable, but we do not focus more than 20% on control the rest 80% should be forward. We have a focus to ensure that the company has auditing skills within the company, which is usually the CFO.

We do not change the use of the audit if we have trouble with the company but we replace the accounting firm regularly for various reasons.

Some companies in our portfolio use their auditor more frequently than others, usually due to less accounting experience. However, it is not due to our decisions.

**G2:**

We use auditors for the normal causes, the most important is to address the development costs. We do not use internal auditing systems, since the companies we invest in are rather small. But we have a due diligence process that somewhat helps us ensure the quality of the financial statements which is often seen as a good assurance for further investors.

We do use external auditors on board meetings sometimes before, especially before annual meetings. This is mostly when the companies have been up and running for a couple of years and started to sell.

We change the use of auditing depending on the size of the company and how it develops. Smaller companies do not need to be audited as closely, since they are small and does not sell that much. The usage of auditing can also differ between the companies in the portfolio, companies with less accounting experience call their auditor more often. However, this can be very expensive.

**G3:**

We assign an auditor when we invest in a company, and will change the auditor rather frequently. It is never good to have the same auditor for too long, it is good practice to change. The auditor is often with on a board meeting before the annual report is finalized to explain and answer questions regarding the financials. The Board may look at the financial statements, asking questions to the auditor and then signing it.

The companies we invest in are usually too small to need internal auditing systems. We have one medical technology company who has 30 employees and a telecom with 100 employees and these have it but not the smaller. These are companies that have existed for 10 years. The use of auditing differs between the portfolio companies for the same reason, the larger the company, the more complex financials and therefore also more need for auditing. The most important factor is the capitalized development costs. It can be quite a lot of money so it is pretty important that it is done properly and then can there be a dialogue with the auditor. However, difference between the uses of accounting between the companies can also be due to difference in work method of the accountant. Some accountants are going through the details and ask questions, whereas other auditors just say I take no responsibility for how you capitalize but here are the rules you must follow them, and then sign the report.

**P1:**

We work very little with auditing, both external and internal. We use auditing to ensure that the management knows all important legal aspects and to ensure that the financial statements are correct, but not more than so. External auditors can be expensive. However, we demand that the companies we invest in follow the rules and pay their taxes, a good citizen approach you can say.

We do would use auditing differently if we would to see a failure from the management and incorrect reports or inventory, but it has never happened. We do use more auditing the bigger the company since it then needs more structure, and less if the company is smaller.

**P2:**

It is to us important to use financial auditors and to have a very close relationship with the auditor of companies. It is an important parameter, the management can call the auditor they need help with some legal or more technical aspects such as reviewing agreements. However, we demand that the companies have the archives right and documentation properly arranged and all that. So it is a part of our job but we do not use any internal audit systems in our portfolio companies. We have always auditors even if we have knowledge our self, partly due to regulations but also to have someone independent to monitor as well.

It happens often that we change auditors when we come into the company because we want somebody who we know does a good job. In case of a crisis, we sometimes need special reviews of the accounting or when you are facing reorganization. Then the auditor used as a consultant. That way it can be differences between our portfolio companies, where some uses the auditors more as consultants.

*Ad hoc communication*

**G1:**

How frequently we communicate with the management varies. In a new investment we communicate rather often and in a mature investment where it is going according to plan, it becomes the less often. So it varies with the stage you could say. Initially it is at least at a weekly basis we telephone contact with the CEO. In more mature companies that are more predictable, and where we know how it works, it is not every week that we need to talk with the CEO. It is also a question about personal chemistry, you talk more to some than others. This dialogue with management it is extremely important, again more important in earlier stages so we can help when the management team is be built.

The communication is mostly about checking if they are following their plan but even more about forward-looking and strategic issues. We cannot do much about history but we can learn from what went wrong. However, the key work of the board should be to formulize

strategies.

We change the communication depending on how the company develops. Communication is more frequent and at the basal level in an initial phase, since the companies have less structure and routines then.

**G2:**

I would say that we communicate very often with our portfolio companies, but we do have all extremes. With some we communicate ad hoc on a daily basis and with others it can take months between the contacts. It is usually that way that you speak more with the less experienced and less with the ones who have done the process before. But we always try to communicate as frequently as possible, I think it is very important. To us, an investment is much like a marriage. It includes an agreement and such. When you invest you must like each other and feel that this is mutual, for otherwise, so there's greater risk that it does not work.
Most of our communication is about support and to help out in various issues. With my background it is more financially and I cannot help with the profound issues regarding technology, but I can have other colleagues who can help.

The more a company grows, the more you need to have a formal board and get more distance to the owners so you get more and more of a wall. You build the wall slowly. I do not think that in a small company can have high walls, for it is often about finance, 3, 6, 9 months, and then you need this frequent dialogue. And then you do not have a corporate governance structure in the same way as in large companies.

How much we communicate with the portfolio companies are dependent on different aspects, such as what stage they are in, how much previous experience they have and what they do.

**G3:**

How frequent we communicate with the companies differs and goes in waves. Sometimes it is several times a week for two months or so, and then go down to two times a month. This is usually around the time when you work with future financing, such as share issues or when something else significant happens such as if the company will sell or to buy a new company.
The communication is very important and also to adapt our communications to match the company's need, but it also differs depending on how mature a company is. If it is a very

good strong board and a very good management and the company is running well, then we communicate less directly with the CEO.

I would not say that the communications' target is control, rather competence sharing. We try to solve issues together, like a financial predicament or a recruitment process. If you feel that you need more control you can attend the board meetings or to have individual meetings with the CEO. Some CEO might say "no I have no time for that kind of meeting" while others say that I like to take a lunch once a month so we can talk. With some people this works well, others you might have less easy to work with. But that is just the way it is. We do change communication somewhat depending on how the company develops. You have to work in a way that maximizes the probability, but this can sometimes lead to disagreements and issues.

Who the interaction with management changes depending on how the company develops depends on what influence you have in the company. We should first choose which battles to take, there is much you can have opinions about in the company but you cannot argue about everything always. You get to choose your battles. But it depends on what you have for formal and informal status.

**P1:**

We communicate with management at least on weekly basis, sometimes more often. The conversations can be shorter but some are longer. The minimum is that we communicate monthly. The dialogue with management is very important and is the best way for us to do an assessment of good and bad investments. We will always try to work as closely with the management as possible. This way we can make it a little better and possibly get it to lift of.
The goal with the communication is probably 50/50 divided between competence sharing and monitoring. You could say that ambition is always to try to put more emphasis on future developments but you cannot help when you talk to management to hear "between the lines" and therefore spot problems early. Some people tend to be a bit hesitating to come forward if there is any trouble, they think their job is to make us investors happy. Then you got to explain to them that we will not be more pleased to hear how beautiful the weather is like, instead you should tell us if there might be an upcoming problem. The communication reduces the control part. Above all the communication changes it if the companies get listed. Then you must respect the regulations, like insider rules and stuff. And so there are a bit stricter. Before that, there will be no change.

The communication might differ between the portfolio companies, the main reason for that is the human factor. Some people are more outgoing than other. However, we always try to communicate the same amount with all. But we should adapt it to the ones who run the companies. Some like the more "to the point," and others like more discussion. We are always trying to guild the companies as well as we can.

**P2:**

If there is some kind of a crisis, or problem with in a company, we communicate more often with the company, perhaps daily contacts for a long time. In the normal case we probably talk to the company once a week to see if it develops according to plan. It varies, sometimes the communication is more frequent. The dialogue with management is really crucial. You must feel that you have mutual trust, and that the management understands what we want and what we think and we believe. The goal with the communication is mainly to share competences. The communication changes depending on the stage the company is in. in the beginning, the focus may be a lot of technical progress, liquidity, while at a later stage, its other issues, such as more strategic.

The communication approach between portfolio companies difference some between the companies. It depends some on the individuals in the company, there is those entrepreneurs who are very communicative and there are those who are a bit more restrained. But it is always good to have the communication, and also to react of the frequency of the communication changes. Then it might be a problem somewhere.

# 5. Analysis

*When analyzing the answers from our five respondents we will try to compare them and find differences and similarities in governance strategy concerning private- and governmental VCs, but also discrepancies in relation to existing studies. We will focus on noting patterns, themes, seeing plausibility & explanation building.*

*Board of Directors*

Our respondents had a concordant view on how you as a VC should compose a board in collaboration with an entrepreneur. All of our respondents answered that board size should range between 4-7 members, with 5 members as the most desirable. The reason mentioned for this was that 5 board members is an uneven number, but above all that the boards with this size not has too many and not too few persons. What we saw that was a slight difference between the governmental- and the private VCs were that the private often got more mandates in the board than the governmental, which all of them answered that they have one representative in the board. This might the result of that the governmental VCs choose to invest together with other VCs, and therefore their number of mandates is less than if they have invested alone. It is possible that the governmental VCs see this co-investing as a way of decreasing risks and that this results in opportunities to invest in more projects. This result is in line with the Van den Berghe and Levrau (2002) study which concluded that VCs in general are willing to take seat in the boards and be active in the daily work. Comparing our findings to the Rosenstein et al. (1993) study we agree that the size of the boards in VC industry comparing to big listed companies are smaller. However our result is not in line with the fact that the VCs often are in majority.

When our respondents discussed the process of composing the board and what knowledge and skills are required to be successful, we find that our targets had a congruent opinion regarding this. They all discussed this in terms of the importance of having a diversified board with knowledge in all areas, especially business experience and experience in running young start-ups. They saw board involvement as one way to get information and be able to complement with new competences. One thing that we have observed was that the governmental VCs choose to shed light on the importance of segregating the roles of the CEO, the board and the owners. This segregation and the use of an assigned board member with experience in the business, was used by the governmental VCs to decrease the information asymmetries

between the board members and the CEO. This tendency from the governmental VCs is something that we see as strategy to avoid being in an inferior position. The private VCs did not seem to work in same way. Instead, the private VC firms seem to work closer to their entrepreneurs so they do not have the same interest or need to reflect upon roles and separation. This behavior from the governmental VCs is much the same as in the Gabrielsson and Huse (2002) study which found that VCs wants to reduce information asymmetries. The governmental VCs also mentioned the importance of having a chairman that is independent which the private VCs did not discuss. This finding also supports our theory that the private VCs work closer to the entrepreneurs when they do no focus on having an independent chairman. The active interaction and involvement in the boards is supported by Hisrich et al. (1998) and Gabrielsson and Huse (2002) studies.

All of our respondents thought that complementing the board with new competences was one of the prominent tasks in board work. They often mentioned this as one of the reasons why they are committed in the board, to evaluate which competences they need to handle the challenges in present but also those coming up in the future. They all saw replacement of board members and executives in the management team as something necessary and vitalizing. The need for competences in the firms was different depending on what stage the firms belongs to and what business they operate in. Some areas where outside knowledge was mentioned as most critical were for example in finance, reporting, contracting and structuring. It is hard to generalize except from the fact that complementing is important. Our result is in line with the study made by Sheu and Lin (2007), who find that VCs in general allow independence considering board composition.

Also when it comes to electing internal or external board members, our respondents discussed in much of the same manner. They often placed their internal representatives in the beginning of the collaboration which later was replaced or complemented by an external part that possesses important competence. There were no differences between the governmental- and private VCs, instead a focus on building best possible board. This result that our VCs appoint external representatives is not in line with Van den Berghe and Levrau (2002) study who found no consensus that the VCs were willing to bring in external knowledge in form of outside directors, despite their own people. Instead our result is more similar to the Hisrich et al. (1998) article in which they found that outside representation is a common feature in VC industry.

Looking at their investments over time and how they allocate their time and on what tasks, the governmental- and private VCs focused on quite different things. The governmental VCs chose to mention liquidity problems, developing technology, finding markets, new financing rounds and increasing exposure to their investment when the firms grow, as time consuming work in the board. The private VCs however, were talking more about how time consuming it was to build good personal chemistry, build mutual respect, building good teams and how to change the leadership situation. The private had a focus on personal relationship- and qualities were the governmental instead focus on in which areas or tasks they contribute the most. So also this support our thought presented earlier that the private VC firms focus more on how they interact with their partner and the importance of it, where governmental VC firms center their attention on more activities related to different tasks and/or business areas.

Comparing our answers regarding the VC interaction changes relative to firm performance, to the theories mentioned in the theoretical framework, we cannot conclude any characteristics in how Swedish private- and governmental VCs change their behavior due to firm performance. Only one of the respondents answered that they chose to work more with the high performing firms than the bad ones, and that VC was a private actor. One explanation for the bigger patience by the governmental VCs to the low performing firms might be the attentions from governments that they should stimulate small businesses and help young start-ups. As one of our respondents said: *"I usually try to explain our work with, if you have been on circus, those kinds of plate artists which have plates that swirl around on bamboo sticks. What is it that he does, well he runs towards those who begins to fall and get them going again, that is approximately how we work."*

A general conclusion from this study is that the VCs do not accept a situation where the CEO and the Chairman of the board is the same person. There was consensus about how this duality should be handled and why this problem should be avoided. There was only one case in which the CEO and the chairman was the same person and that was preceded by a removal of the CEO, so that was just a solution over a short time period. This supports Gabrielsson and Huse (2002) general findings that CEO duality is less common in venture backed firms. When analyzing the answers on how the VCs opinions regarding the entrepreneur as a CEO, we find similarities in the descriptions from the VCs. They did not think that an entrepreneur or an innovator always is the best person for the role as CEO because they sometimes lack the

competences needed for the job. If an entrepreneur is the CEO, which often happens in early stages where the firm size is small and where they still can work with the technology which they find most interesting. This action from our VCs is in accordance with the study made by Hellmann and Puri (2002), which found that VCs often replace the founder from being a CEO. Further, the Khanin et al. (2009) results that VCs have mixed tolerance for the entrepreneur as CEO, we also found support for.

When the VCs removed the entrepreneur from the CEO position, we find separated tactics dealing with that person. Most important factor for keeping the removed CEO was the individual competence and the ability to adjust to the new leader. If the change was due to personal conflicts, the entrepreneur was forced to leave the firm. One governmental VC said that if they experience problem with entrepreneur, they cancel their commitment in the firm. But we did not see any clear pattern in the behavior of the governmental VCs versus the private VCs. Finally our respondents thought that their most valuable contribution to the firms consists of experience, network, financing, and replacement of management- and board members. This is much the same as Sapienza et al. (1996) result. What could be a slight difference in the answers about this between the governmental- and private VCs, was that the governmental VCs revealed that they through their involvement contribute with stability and confidence to the firm and therefore a kind of due diligence. This thought can be seen as a more social goal comparing to financial measures.

*Interim reporting*

The way both governmental and private VCs use interim reporting as a mean of corporate governance seem to be rather similar. The standard seems to be to receive quarterly reports and CEO reports at a monthly basis. The CEO reports seem to include similar items such as important events, follow-ups of recent events and financial reports. This might not be due to VCs corporate governance decisions, yet instead due to the CEOs somewhat standardized template. This is in line with the findings from Gibson (2009).

Both groups frequently mention liquidity as an essential element to monitor by the use of interim reports. This can be explained by the stage of which these VCs invest in. In an early stage, when the cash flow is not substantial or even positive, the liquidity is often the critical part. Hence, this might not be as much of a strategic corporate governance mean, instead more of a standard business trait. The same goes with reports regarding sales. For a company to

survive and be sustainable they must generate money, so the sales focus might not come as a chock. However, we, as interviewers, felt that one private VC had a more intense sales focus than the others we interviewed. It might be that this is a more common strategy of private VCs. Nevertheless, we cannot draw that kind of conclusion from our case studies.

One governmental VC also had a strong focus on tax payments, since it would be embarrassing for a governmentally financed VC firm to help companies who did not pay taxes. No one of the private VCs ever mentioned this as a mayor area of importance, however, one mentioned that they had *"a good citizen approach"* and might therefore also have a similar focus.

However, they did differ on one area. The private VC had more emphasis on a tailored approach where one said that they wanted financial reports to be "*adjusted for each company*" and the other that what "*we want to have reported is individually tailored*". Hence, the private VC might have a more situational driven reporting strategy than the governmental. The governmental might have somewhat of a more standardized strategy, perhaps due to stronger regulations from their owners.

Interim reporting seems to be a good mean for maintaining a satisfactory level of monitoring, but when problems occur, it might be of less importance compared to ad hoc communication. The way that the governmental and private VCs use interim reporting seems to be similar. However, the governmental might be more standardized than the private. Even though we could see some differences between how they worked with this, it might just be a question about situational comments.

*Audit Certification*

The most common use of auditors seems to be to use it for the legally demanded auditing of the financial statements. The VCs also seem to occasionally bring the auditor to the board meetings before annual reports, so they can answer questions and explain their auditing.

Further, they seem to agree that an auditor can be good to use in order to ensure that the entrepreneurs have all important knowledge of law and regulation. As one VC stated it *"[w]e use auditing to ensure that the management knows all important legal aspects and to ensure that the financial statements are correct, but not more than so. External auditors can be*

*expensive"* and another *"the management can call the auditor if they need help with some legal or more technical aspects such as reviewing agreements"*.

Both governmental and private VCs seem to include in the shareholders' agreement that they will have the right to assign a new auditor or change the existing one. One said that we *"assign an auditor when we invest in a company, and will change the auditor rather frequently"*. This seems to be a mean to increase monitoring and therefore potentially decrease the risk of the investment.

Capitalization of development costs also turned out to be a significant issue of accounting and therefore also an important area for the use of auditing. This seems to be the same for both governmental and private VCs and hence, could be more of a business problem than governance related.

The VCs said that they might use auditors in case of predicament or if they are suspicious about fraudulent behavior which is in line with Kumar and Shama (2005). *"We would use auditing differently if we would to see a failure from the management and incorrect reports or inventory, but it has never happened* "one of the VCs explained. Another said that "*[i]n case of a crisis, we sometimes need special reviews of the accounting or when you are facing reorganization. Then the auditor is used as a consultant"*. This is made to increase monitoring, and since it is made in case of emergency, the focus is most likely to decrease risks and secure what is left of the investment.

Some of the portfolio companies might use auditing services more, but it does not seem to be a strategic choice of the VCs. Instead, it seems to be a choice of the entrepreneurs and done as a complement for insufficient accounting experience. However, this might not be a popular mean of knowledge, since most of the interviewees mentioned that auditors are expensive.
Our respondents answered that their portfolio firms do not use internal auditing systems, unless they are very big which is similar to what Schartmann (2007) said in his study.

*Ad hoc communication*

Analyzing our respondents' thoughts regarding ad hoc communication and the importance of communicating with management teams in their portfolio firms, we could see a homogenous way of thinking and interacting. The interviews revealed that ad hoc communication is one of

the most important tasks for VCs to deal with when investing in young start-ups. The amount of time the VCs spend on ad hoc communication fluctuates and varies depending on certain factors. The most mentioned factors were in what stage the portfolio firms is in, experience in the management team, firm performance and personal chemistry and personality. The VCs spend more time on communication in early stages where there are more uncertainties to deal with, when the management team is less experienced, when problems occur and if the persons in the management team like to have a close and regular communication. These findings are in line with the Sapienza and Gupta (1994) study which disclosed that VCs in general are more active in the interaction if founder was less experienced and when the investment was in an early stage. Thus this contradicts the study by Sapienza et al. (1996) which showed that in Europe, VCs interacted more when the CEO had greater start-up knowledge. Overall, our respondents answered that they communicate at least once a week with their partners in early stages, when investments more mature it could be once a month.

A slight difference between the private and the governmental VCs is that the private VCs focused a bit more on communication when there were problems and also the importance of discovering problems when listening to the management team. One private VC told us that ”*it is very important to be observant on those management teams which have been communicative and suddenly becomes restrained, and also on those who have been restrained but change to be out-spoken and reflect ‘what is going on here?’*”

The governmental VCs did not mentioned this in the same way as the private did, they instead talked about how the communication differs depending on different situations and that the communication is most about competence sharing to the firm. We had one private VC that said that the goal with communication was 50% control and 50% forward looking, so it might be that the governmental- and private VCs have slight differences in the way they use the information received from the communications.

A good communication can build mutual trust and understanding between the parties and is therefore of high importance. One of our respondents chose to formulate it like this:*”Investing in firms is like a marriage, you enter an agreement and if you are not happy you notice it right away. But it is important when you invest that you feel that you fit together and that this is a mutual feeling, otherwise there is a risk that it will not work”*.

This is supported by the Cable and Shane (1997) study showed that it is important for the VCs to stimulate personal contact between the parties. Building a good relationship and mutual trust is of high importance as Higashide and Birley (2002) mention in their article.

When asking about how their governance strategy differs compared to other VC firms, the private VC firms thought that they work closer to the entrepreneurs and not so much about formalities. This indication from the private VC firms is something that we have noticed when analyzing the answers from the governmental and the private VC firms. If not a radical difference in the governance strategy so at least a heterogeneous nuance in how they talk and think about communication and board work in the VC industry.

# 6. Conclusion

*In this chapter we will conclude our findings regarding the Swedish private and governmental VC firm's corporate governance strategies, and present a model of corporate governance strategies in the VC industry. We will also discuss recommendations for further research.*

## 6.1 Conclusion

We can from our answers notice that governmental and private VC firms in most aspects have a similar approach to governance. The purpose of the study is to describe and compare private- and governmental VC firms' corporate governance strategies and if they are different due to their heterogeneous targets from their owners. We believe that the fact that many of the Swedish VC firms, which have decreased over the last years, invest together in several projects, have led to a similar operating procedure when it comes to board compositions. However, the most evident difference between our two groups is that in some aspects, the private VC firms tend to focus more on the personal relationship with the entrepreneur and to work closer with their investment than the governmental VC firms which might be a result from the difference in targets from the owners. In the text below we will present a brief presentation over the main characteristics of how governmental and private VC firms work with the *board of directors*, *interim reporting*, *audit certification* and *ad hoc communication*.

*Board of Directors*

The targets had a congruent view regarding the importance of having a diversified board with knowledge in all areas. They all mentioned complementing with outside competence as a reason why they are committed in the board. Most of our respondents work more with bad performers than good, since they often are in more need of urgent help. The main difference we found was that private VCs seem to work closer to the investments than the governmental, and that the private had an increased focus on personal relationship and qualities whereas the governmental instead focus on specific tasks.

*Interim reporting*

The use of interim reporting as a component of governance seems to be similar in our study. However, the private VC firms in our study seem to have a more tailored approach to reporting. Further, we can conclude that interim reporting seems to be a good way for

maintaining a satisfactory level of monitoring, but when problems occur, it might be of less importance.

*Audit Certification*

Our VC firms mainly use auditors for the legally demanded auditing of financial statements. However, the use of audit certification and services would change if they have suspicions about fraudulent behavior. More auditing use in different firms seems to be more due to the entrepreneur's limited accounting experience than a strategic choice. Finally, the use and importance of audit certifications increases with the size of the company since a larger company is more complex in its structure.

*Ad hoc communication*

We can notice that our respondents have a somewhat homogeneous view regarding the importance of communication and interaction with the management teams. They all agree upon communication as one of the most important tasks for the VC firms. They spend more time on communication when the management team is less experienced, in an early stage, when problems emerge and when the personalities in the management team is comfortable with a close contact. There was a slight difference in that the private VCs focused a bit more on communication when the portfolio firms experienced problems and the importance of discovering problems when listening to the management team.

## 6.2 Ormberger-Törnqvist CGS-Model

From the theories used in this thesis, together with the empirical data, we have constructed this model. The *Ormberger-Törnqvist CGS-Model*, or Ormberger-Törnqivst Corporate Governance Strategy-Model, demonstrates the formulation of a corporate governance strategy and is applicable to all VC firms. It has its foundation in the Beuselinck (2007) research framework, but has been augmented with other research such as; Rubin (2009), Manigart (2002), Wright and Robbie (2002), Cumming (2010), Van den Berghe and Levrau (2002), Hisrich et al. (1998) and Higashide and Birley (2002), Sapienza et al.(1996).

The model can be used for two purposes; 1) to analyze and describe the current corporate governance strategy of a VC firm and 2) for VC firms to use when deciding and evaluating their corporate governance strategy.

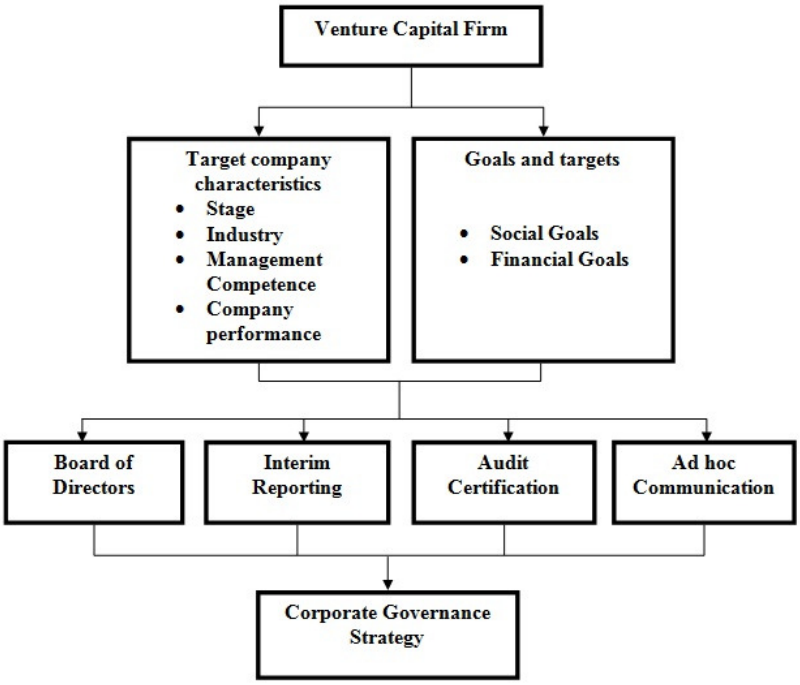


Figure 2, Ormberger-Törnqvist CGS-Model, Ormberger,F. & Törnqvist, M. (2011)

The model begins at a VC firm who needs to formulize their corporate governance strategy. After that, the model goes down to two main groups that influence the strategy; *target company characteristics* and *goals and targets.*

*Target company characteristics*

As both previous studies have shown, such as Hisrich et al. (1998) and Higashide and Birley (2002), as well as our empirical findings, the corporate governance strategies are dependent on some target company characteristics such as; stage of development, industry, management competence and company performance. Hence, the corporate governance strategies differ depending on these previously mentioned characteristics.

*Goals and targets*

The goals and targets that the VC firms have, both financial and societal, are also items that affect the corporate governance strategies. If the firms target is financial returns, their focus should be to support and help the company to achieve higher growth and cash flow, while if the target is societal, the focus should be more on monitoring and to ensure that taxes are paid.

These two groups; *target company characteristics* and *goals and targets* should together influence the means of corporate governance.

*Board of Directors, Interim Reporting, Audit Certification & Ad Hoc Communication*

How the VC firms uses the means of corporate governance is dependent on the two previously mentioned groups. To clarify, if the company is in early stage and the performance is good, the VC firms will work with the four means in a different approach than if the company is in a mature stage and has issues with the performance. Hence, each target company characteristics, and goals and targets of the VC firm, should influence how they use these means of corporate governance.

*Applicability*

As previously mentioned this model is applicable to all VC firms and is a helpful tool for both evaluating and describing corporate governance strategies as well as formulation of corporate governance strategies of VC firms. This model is also applicable to the work of business angles, business angle consortiums and PE firms. However, as mentioned in the method chapter, when analyzing corporate governance strategies of PE firms a fifth mean could be added; compensation for management.

## 6.3 Recommendations for further research

As we discussed previously, there is a need for more studies within this area. The importance of corporate governance has increased, and hence also the need for more knowledge. Further, since the impact of VC and PE in the economy has increased significantly, so should also the research regarding this. We have found a lot of articles regarding each of the two topics; corporate governance and venture capital. However we have found only a little amount of research conducted on the two together. Here we see a need for increase research. Additionally, most of the studies we have read have had a quantitative approach and describing the impact of corporate governance rather than the use of corporate governance in VC firms. The study of this thesis can be elaborated a lot and therefore increase the knowledge regarding this topic. Future research can aim to investigate a larger quantity of VC firms, VC firms from more regions or countries and also to PE firms. Using the *Ormberger-Törnqvist CGS-Model* can be one method to do it, which would help the comparison between the research conducted.

Finally, to increase the validity of the data by reducing the interviewee bias, future research can also interview some of the portfolio companies. This could provide an extra view

regarding the corporate governance strategies and see if there are any discrepancies between what the VCs said that they are doing, and what they actually do.

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# 8. Appendix

## 8.1 Interview questions

**Formalities**

**Thesis - corporate governance in VC firms**

**Interview Process**

**I. General questions**

**II. Board of Directors**

**III. Interim Reporting**

**IV. Audit Certification**

**V. Ad Hoc Communication**

**Explaination**

**1) Board Work = Work with the boards of portfolio companies**

**2) Management = The senior management of portfolio companies**

**3) Ägarstyrning = Bolagsstyrning = Corportate governance**

**Name**
**Position**

***Descriptive questions***

How much money do you have invested?

Number of investments?

Number of employees?

From what background/ what skills your staff have?

How many years have you been in business?

Which regions invest in you?

How does your ownership structure look like?

***General questions***

How do you work with corporate governance in your portfolio companies?

How important do you think the corporate governance is in a collaboration between a venture capital firm and a entrepreneur?

Is there a conflict between innovation and corporate governance?

What problems are you experiencing?

How do you include corporate governance in your original agreements between you and the entrepreneur?

How do you think your corporate governance strategies differs from other VCs'?

***Board of Directors***

How many board members do the boards of the companies you invest in consist of?

How many of these are your representatives?

What is the most important factor when you compose a board?

Are there any differences in how see the board and view its importance when you invest in different sectors, depending on the size of the investment or when you and the entrepreneurs' experience in the field differ?

In what way does the portfolio companies' success change the strategy for how involved you are on the board?

How does your interaction and strategy change when the investment grows from an early stage to a more established?

***Internal / external directors***

Do you prefer assign internal or external people to the board?

Do you have a focus on completing the competency of the existing board?

*Time board work*

How many hours do your board members spend on board work and similar activities?

Are there any investments that require more attention than others? Ex trend of how the investment performs, the entrepreneurs competence and personal chemistry between the parties.

*CEO / Chairman separation*

Are there companies in your portfolio where the CEO and chairman is the same person? Pros and Cons?

If the entrepreneur also holds the position as CEO of the company, does this have advantages and disadvantages?

If the entrepreneur is fired from the CEO position, there are incentives to relocate and retain the person within the business?

*Your most important contribution to the board*

What do you think is the most significant contribution that you bring to your investment?

Are there any disadvantages of being involved with the board and if so what?

What do entrepreneurs emphasize as your greatest expertise in corporate governance process?

***Interim reports***

How often you receive interim reports from your portfolio companies?

What do the reports look like and what is reported?

What factors determine how you use reporting?

Do you change the use if the company fails to meet targets?

If you have any problems with the entrepreneur, then you change the use of reporting?

If you require a report, how fast do you want it sent / produced?

***Audit Certification***

How is the board working with audit?

Do you use internal audit systems?

How do you use external auditors?
Do you change your use of audit certification, depending on how the company

develops? And if so, how?

How does the use audit differ in your portfolio companies?

***Ac hoc communication***

How frequently do you communicate with management?

How important is the dialogue with management?

Is the goal of the communication mainly control or assistance with skills?

Do you change your communication depending on how the company develops? In what way?

Does your communication approach differ between your portfolio companies?
In what way?