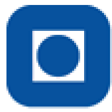

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Optimizing Trade Sale Exits

Introducing Key Drivers for a Successful Venture Capital Trade Sale Exit

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Problem description

The purpose of this thesis is to shed some light on the black box of trade sale exit of venture capital backed small medium sized technology companies. The ambition is to better understand what the key drivers for a successful trade sale exit are.

The two research questions that are addressed are;

- What are the key components to achieve trade sale exit of venture capital backed small-medium sized technology companies?
- What are the key methods to optimize trade sale exit of venture capital backed small-medium sized technology companies?

Preface

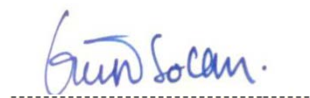
This written work is the master's thesis of the authors, as the final part of a Master of Management degree at the Norwegian university of Science and Technology, specialization in Strategy and Business Development.

The authors have conducted this study while being employed at RESMAN AS, a venture capital backed technology based company. Even though none of the interviewees are employed in RESMAN, nor is the authors' employer used as a case, experience from the work place is used as background for the study.

The main components of this study are a literature overview on the venture capital concept, with special focus on venture capital and exit. In addition the frame of reference includes a limited review of trust, game theory and negotiation. The second component is a qualitative study, including 10 in-depth interviews, conducted summer and autumn 2013. Since all the interviewees provide sensitive information, their names and the cases they refer to are made anonymous. For the same reason, the interview transcripts are not included in the thesis, but can be provided on request.

The authors wish to thank their academic supervisor, Associate Professor Dr. Roger Sørheim at the department of Industrial Economics and Technology Management at NTNU. Sørheim shows instrumental insight into the field and have provided the authors with invaluable guidance and comments.

Furthermore, thanks to all the interviewees. Without them taking their time and effort to share their invaluable experience from the field of practice, this study would not be possible.



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Abstract

The purpose of this thesis is to shed some light on the black box of trade sale of venture capital backed small medium sized technology companies.

The theory reviewed is mainly from venture capital theory, taking a special look at what venture capital is and exit. To understand the empirical finding there is a short review on trust, game theory and negotiations.

The research material consists of 10 in-depth interviews with venture capitalists, corporate venture capitalists, business angel and entrepreneurs. They have different roles, but they all have in common that they have worked with or in venture capital backed small medium sized technology companies, where trade sale has been or is the exit vehicle. All of the interviewees have extensive experience, and draw their experience from several cases. The companies they refer to are mainly within oil and gas, some within IT. The main subject in the interviews has been to understand what can influence exit; if there are any specific activities or occurrences that the interviewees regard as a prerequisite to a successful exit, or having a positive influence on exit. What is behind a successful exit is not defined, and hence regarded as a subjective matter.

There is no doubt that the research material stress that a successful exit is related to the entire investment process, not only to the exit phase. To understand the key drivers for a successful trade sale exit of venture capital backed small-medium sized technology enterprises, it was therefore crucial to understand what is important when building the company and what is important to do or not to do when preparing the company for an exit. This is the basis for the authors' two research questions; 1) what are the key components to achieve trade sale exit of venture capital backed small-medium sized technology companies?, and 2) what are the key methods to optimize trade sale exit of venture capital backed small-medium sized technology companies?

Even though different roles have different views of what is important when building and preparing a company for an exit, the study showed that regardless of role, there are certain key drivers behind a successful exit and that these elements are very much related to each other. From the empirical findings there are a set of components necessary to achieve trade sale exit, these are; 1) competence, team and culture 2) networks, trust and collaboration and 3) strategic alignment with potential buyers. Furthermore, to optimize trade sale exit there are identified two methods which are 1) socializing the business and 2) playing the game.

Furthermore, the study strongly indicates that these elements are related to each other, and should not be regarded independently. Rather building a company and preparing it for an exit should be perceived as a process, where these key drivers should be part of the process.

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1 Introduction

Innovation is identified to be a major contribution to economic growth and job creation. Venture capital backed start-ups are an important source of innovation and technological development. For many big companies acquisition of these small start-ups is a strategy and way to achieve new capabilities, intellectual property, visionary and innovative solutions. Larger firms struggle to innovate their resource base, often due to path dependency. Even innovation-driven organizations need outside assistance with innovation. Hence, acquisition of smaller companies is important for larger companies.

Startup companies face a number of resource constraints in creating successful spin-outs, however several studies point to finance as a major obstacle (Sørheim, 2006). Many small start-up companies have capital demanding developments to reach their growth potential, and at some stage of their development they need financial support beyond the entrepreneur themselves. A gap between the need and the available finance has been recognized and addressed in several policy initiatives both in the US, and in Europe (European Commission, 2007). Risk capital provided by venture capital firms has been seen as a major solution to the gap.

Venture capital firms provide capital in high potential and high risk ventures and are considered one of the major sources of finance available to entrepreneurs (Wright, 2006). Even though regarded as one of the major sources for financing, a venture capital backed company goes through an extensive due diligence before getting access to the capital (Stein & Mathiesen 2006). The ventures typically do not pay dividends, and the return of investment is instead harvested through an exit. The ultimate goal of the venture capitalist is a successful exit, with a good return on investment. The most common exit routes are initial public offering (IPO), buy out or a trade sale (EVCA, 2012). Trade sale is by many seen as the primary and preferred exit route for venture capital (Gompers & Yuan 2009). And even though trade sale is by far the most common exit vehicle, might have given the most successful exits and are increasing over the last decade, the majority of research look at IPO's and not trade sale. Venture capital backed trade sales have gained little attention from academics, probably due to information not being public and hence not available. The process and players in a trade sale are different from an IPO, thus the research material is not applicable to understanding trade sales.

Even though financing is the most obvious contribution from venture capitalists to their portfolio companies, there is an assumption that the venture capitalist adds more than money. Their contribution is also called smart money or non-financial value-adding (NFVA). There is a great deal of research on venture capital and NFVA, looking at what NFVA is, questioning if NFVA actually occurs, and if so, how it affect the performance of the venture and ultimately the value. Various activities assumed to be important for growth have been investigated, and the research suggests that the ongoing cooperative relationship between the entrepreneur and the venture capitalist is as important to the performance of the venture as the venture capital provided (Cable& Shane 1997; Shepherd & Zaracharakis 2001; De Clercq &

Sapienza 2001. However there are still inconsistent conclusions on if and how the venture capitalist effects exit (Large & Muegge 2008).

Furthermore, there are few, if any, investigations on what makes a successful trade sale for venture capital backed small-medium sized technology enterprises. This is a gap in the research. This thesis contributes to filling this gap. It investigates if there are underlying conditions that brings value and prepare the company for a successful trade sale. Not only considering the venture capitalist, but the whole ecosystems of roles related to trade sale exit of VC backed companies. This is an important contribution to the research, as there is no research having a holistic view on what ensures a trade sale exit and what contributes to a successful exit in venture capital backed small-medium sized technology enterprises.

This thesis starts with a literature review on the venture capital concept, with special focus on venture capital and exit. To expand the frame of reference there is a limited review of trust, game theory and negotiation. The second component is the empirical finding from a qualitative study, including 10 in-depth interviews, conducted summer and autumn 2013.

1.1 The Thesis

The aim of the thesis is to provide the reader with more insight into the key drivers for a successful trade sale exit of venture capital backed small-medium sized technology enterprises.

The two research questions that are addressed are;

- What are the key components to achieve trade sale exit of venture capital backed small-medium sized technology companies?
- What are the key methods to optimize trade sale exit of venture capital backed small-medium sized technology companies?

It starts out with a frame of reference based on literature and research studies to provide the context in which the study is done. First the venture capital concept which cover the areas of what venture capital is, the due diligence process and how this is in small middle sized companies. Following that the state of the art literature of venture capital and exit including some relevant statistics to emphasize the importance of trade sale exits. For further reference, as the trade sale exit involve many stakeholders and the process includes negotiations, general theory on trust and relationships, and negotiations are described.

The thesis is structured as an exploratory research based on in depth interviews. The methodology used are explained and also included in the analysis when appropriate.

The analysis is performed based on extracted data from the interviews and referenced literature. Analysis and discussion is divided into two main parts; 1) components to achieve trade sale exit, and 2) methods to optimize trade sale exit. Subsequently, the summary of the

findings, analysis and discussion are explained and presented in a figure, to provide a model and a set of tool for practitioners to succeed in future trade sale exits. Ultimately, the study concludes and takes a closer look at implications, also suggesting areas for future research.

2 Frame of reference

First the venture capital concept which cover the areas of what venture capital is, the due diligence process and how this is in small middle sized companies. Following that the state of the art literature of venture capital and exit including some relevant statistics to emphasize the importance of trade sale exits. For further reference, as the trade sale exit involve many stakeholders and the process includes negotiations, general theory on trust and relationships, and negotiations are described.

2.1 The venture capital concept

Venture capital (VC) has become an increasingly important source of financing for new companies, particularly when such companies are operating on the frontier of **emerging technologies and markets** (Tyebjee & Bruno 1984, Sørheim 2006), startup companies with high risk and high potential gain. That means that venture capital usually invest in companies with very little history of performance which therefore is difficult to predict. The companies are also usually small so the relationship between the investor and the company involves higher degree of direct involvement. With new technology and market, the time to realization could be long and there might be need for several rounds of capital infusion. The venture capital funds act according to agent theory with respect to agreements (anti-dilution and specific rights etc.), monitoring/control and staging of capital.

They can be categorized in to three types, informal VC's or business angels, formal VC's and corporate VC's (CVC). The formal VC's have been the focus in most studies, and will also be the main focus in this thesis together with corporate VC.

VC's seem to be more often the lead investor than CVC. In addition to a high potential for the object, CVC invests in companies that have complementary technology to their mother company to obtain synergies between the two. They also have the ability to fund earlier, the seed phase, that VC's. In Norway the number of CVC are limited. The CVC do have more focus on the technology and seem to be more patient regarding time of exit than VC. As CVC are parts of a large concern they have a high standing in the market and also as a part in legal issues. Due to the internal technical resources the CVC may contribute with activities that add value to the company within technology development in addition to the business development.

The decision process for VC investment activity has been described as a five step process (Tyebjee & Bruno 1984) in which the first four are activities that occur pre investment and the fifth are the post-investment activities. In more recent literature in the area, the process has been described as a three stage process (De Clercq et al 2006) where an additional phase is called the Exit phase. This 3rd phase starts somewhere along after investment and ends up

with an exit as shown in the figure below. This show that there is a stage where the focus is more on specific activities related to the exit and that that period is of a certain length in time.

The VC is typically constrained on staff and divides their resources between the three stages. In the pre-investment phase where the investment decision is done, the VC need to screen through thousands of proposal and to select the ones with high potential. Once the potential investment is selected and the entrepreneur and VC agree on mutually acceptable terms and conditions that will help the venture to the next step.

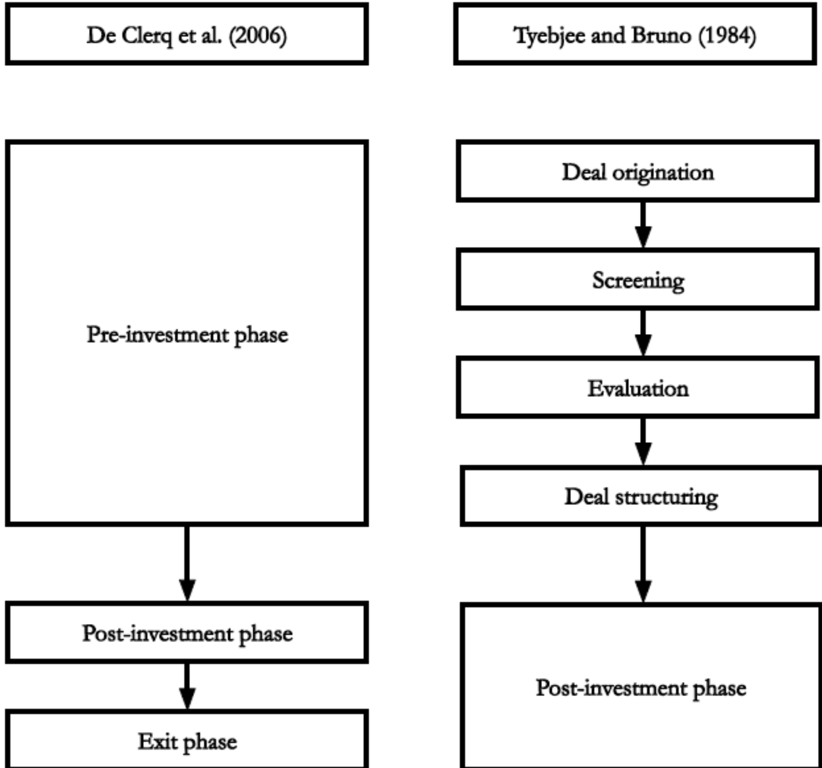


Figure 1.Decision process model of Venture Capital Investment activity (Sunde et al, 2012)

In the Post-investment phase the VC activities changes from due diligence and deal structuring to value adding. Whether VC's add non-financial value to the company has been a focus for research over the last decades Large & Muegge 2008; Busenitz et al 2004; Ehrlich 1994; MacMillan et al 1989) Exit planning starts from day one, and will affect all activities in the post investment phase.

The onset of the exit phase is not uniformly defined or standardized, but there are certain activities that both the VC and the company need to perform to prepare for an exit which is related to this phase.

The typical VC fund (VCF) is organized as a limited partnership, with the VC serving as a general partner and the investor as a limited partner (Sahlman 1990, Zider 1998). From the structure given below it is interesting to note that the investment manager could be in a

similar position as an entrepreneur, in that he or she, periodically, needs to convince outside investors to invest in his company, based on track record and future earnings.

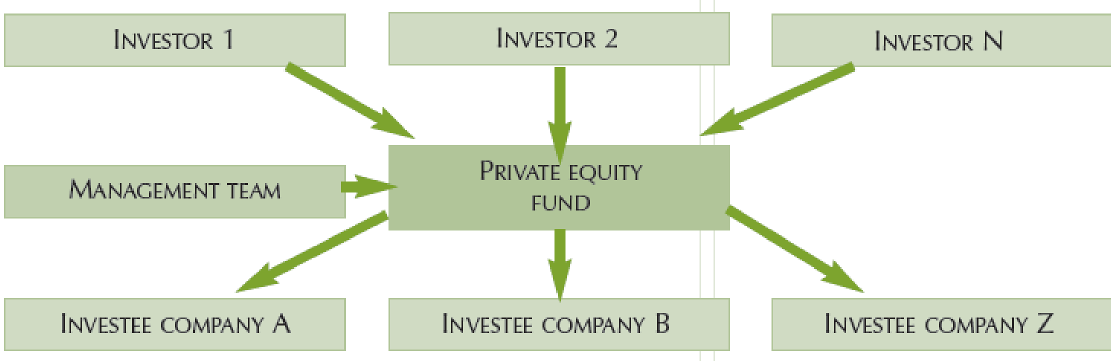


Figure 2 Structure of a typical private equity fund (Deville 2002).

Venture capital funds have a relatively short history in Norway, but have been growing rapidly. Over the years there has been a shift in the **market areas** in which this capital is available, and in Norway the sectors that attracted the highest levels of investment were petroleum, communication, IT, Cleantech and Life Science. Most initial investments were made within the Petroleum sector and IT (NVCA 2009 and 2012). The reason for this is the shift from IPO towards trade sale and the potential buyers and money available in the various areas. Venture capital firms are dependent on return on their investments and will therefore prioritize the markets with the highest potential of return.

Norwegian and foreign funds support businesses with a number of employees corresponding to about 3% of people working in Norway. The timeline of a venture fund is usually a value creation over 3-5years, maybe up to 7 years and only projects with high potential are of interest. Dependent on the composition of investors in the fund they invest **from very early phase up to the last phase of growth (Figure 3).**

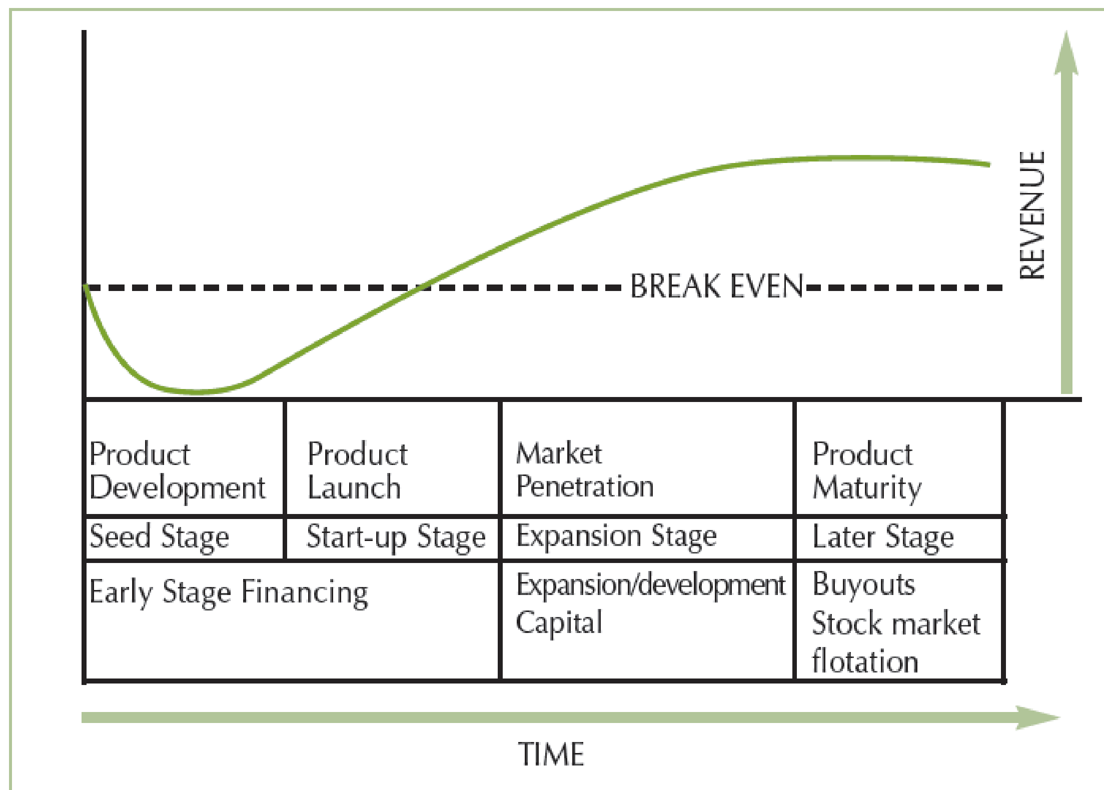


Figure 3. Overview of the different stages, the hockey stick curve (Deville 2002).

External finance from venture capital either via commercialization engines, capital funds management or corporate venture capital funds or individuals, they all demand the inventors or **entrepreneur to participate** in the establishment of the company both in person and with cash. Due to the law in Norway, Aksjeloven, the ownership of the entrepreneur will correspond to his or hers input in cash or IP. If the capital need is high the entrepreneur can have difficulties in participating to a large enough extent and will have minor ownership. The picture of capital need is therefore an important factor to consider for the entrepreneur in the pre-investment phase.

Technology companies which are meant to grow are very much dependent on the financial structure to succeed. From the knowledge of all these different sources the companies need a strategy for how to finance the company development from day one and they also need to make an overview of what their possibilities are. By inviting investors with **financial muscles**, CVC or VC, you can hinder infringement of technology or a hostile takeover.

VC's will contribute with more than just cash, and the management team of a venture fund has usually a large network of people with competence within all aspects of business development. For a young technology company the **access to knowledge** and safety are just as valuable as the invested cash. Initially the entrepreneurs are important as to commitment and enthusiasm for the development of both the technology and to make a business. For a young technology based company, access to competence in all areas should be the major focus when selecting owners and sources of financing.

The sources of finance has impact of ownership and thereby **control** and financial return. Ownership has two types of rights, control and profitability. Ownership rights changes with percentages within limited companies. The various venture firms have policies regarding how much they want to control and be involved in their portfolio companies and invest accordingly. Information asymmetries are higher in small firms, and even more in technology based ones, due to lack of available public information so here the governance either contractual or relationship is important.

Also the plans regarding growth will have implications on the **capital need and structure** of financing (Sørheim 2006). The business plan will make a picture of capital need and how this need change over time, so to be able to make the right choice regarding financial structure, the business plan is of great importance. For a technology company in early stage with plans to grow the added value from the investors are more than just cash. Competence and/or network ties with competence are of great importance (Sætre 2003) in the post investment and the exit phase.

2.1.1 Due diligence

Venture capital is always a time limited financing opportunity. The funds have limited time and there will be a transaction to others at the end of the period. Both in the investment decision and de-investment decision there are a due diligence processes. The venture capitalist does a due diligence on the investment object before investment decision is made, and the acquirers do the same before they decide to buy.

There is a risk associated with asymmetric information between the targeted firm and the acquirer. In addition the value in entrepreneurial firms is often intangible assets such as intellectual property, entrepreneur team's human capital and perceived growth opportunities. In most M&A deals it is normal to conduct a due diligence of the targeted company. In a trade sale process the due diligence is the final check of information given by the seller to the buyer. *"Due diligence should be a comprehensive analysis of the targeted company's business – its strength and weaknesses – its strategic and competitive position within the industry"* (Kissin & Herrera, 1990). This in-depth analysis is either conducted by the acquirer or a hired intermediary. The due diligence process aims to make the acquirer able to understand the risks that are involved when purchasing a company. The due diligence is both decision-critical and determinant of valuation. It is therefore important to better grasp what goes on in a due diligence and how this might affect the exit outcome.

There are several areas of interest, case to case dependent, however most due diligences seem to include at least an analysis of the financial, legal and market aspects. The financial due diligence is focused on financial numbers of the company being acquired. Not only the financial past, but also to make sure the financial structure is substantial. Information should be able to project future growth and earnings. The financial due diligence often pose a go or no-go conclusion for the acquirer. Legal due diligence is focused on looking over the

contracts to prevent future surprises and unexpected liabilities. Personnel and supplier contracts are given special attention. Especially when looking at personnel contracts, the transferability to the acquiring company is given attention. This is also important when the integration is planned, if it is a full or a partly integration. If the company is fully integrated the existing sales organization could be sufficient to handle the sales and marketing. Market due diligence is to validate the premises on which the selling company's business strategy is based. Particular important is finding the market share and market stability. A due diligence of the market tries to get a glimpse of the future, to see possibilities and risks. This stream of due diligence should proceed any other in order to create a list of acquisition candidates. Howson (2003) point out that a market due diligence need to uncover a strategic fit, meaning the products of the analyzed company should complement the product portfolio of the acquiring company. Laamanen (2007) supports this and conclude that effort within R&D is positively related to premium paid in an acquisition.

In addition, a due diligence attempt can uncover the social and human capital in the organization, through an in depth evaluation of the strength and weaknesses of the key executives. There is a risk that key managers will leave, so finding out the attitude and culture of managers and the company is crucial to know how employees will respond to a takeover. It is important because personnel compatibility is the basis for future prosperity after acquisition. Private acquisitions are often done to expand the competence for the buyer within an industry. This view is aligned with a perspective to view the entrepreneurial team as a resource. Fit in management style is important when doing a due diligence, as resistance from the management team can be a deal breaker.

Organizational due diligence aim to find out if the organization is properly build in regards to size and both procedural and hierarchical efficiency. It investigates the responsibilities of the different departments and it aim to understand the decision making process. It is important to avoid clashes in the decision making culture, and other aspects of organizational culture. The assessment will also review the control system. It aims to find out how well the organization is balanced and how the working process is managed.

In a study of post-merger management Sarrazin & West (2011) found 50 - 60 % of the initiatives intended to capture synergies were strongly related to IT. IT should be regarded as one of the most critical aspects of integration and successful implementation of acquired firms. Besides employees, it is assumed that IT infrastructure is the largest investment of the firm, and early and detailed IT planning can make an acquisition unfold more smoothly and realize synergies faster.

Not much relevant literature has been found concerning the due diligence of smaller companies. However, in Sunde and Ekås' study from 2012 the following aspects are concluded to be of importance when doing a due diligence of smaller companies; commercial, financial, legal, strategic, intellectual property (IP) and HR. The financial due diligence plays a less important part in acquisitions of entrepreneurial firms, compared to the bigger M&A.

The reason might be that a financial due diligence of entrepreneurial firms is less reliable due to the lack of operational history.

When acquiring entrepreneurial firms financial and market due diligence is the basis of the “business case”, where assumption and project growth are backed. Since the acquirer seeks to fill a gap when buying, market due diligence is often done in-house at the acquirer. The reason is that they regard themselves to have the best knowledge of the industry and can therefore align it with internal strategic considerations (Sunde and Ekås, 2012). This strategic fit of the entrepreneurial firm is crucial for the acquisition of an entrepreneurial firm. The acquirers stress how important it is with a strategic alignment, they investigate how technology, resources and competence can complement the acquiring company. This process very much add to the commercial and financial due diligence, by combining market knowledge, the target firm’s strategy and the acquiring firm’s strategy to find the strategic value of the target company. Sunde and Ekås (2012) argue that the emphasis on a strategic fit might be the reason why due diligence on entrepreneurial firms differ from the ones on bigger firms.

Additionally, Sunde and Ekås (2012) emphasize the importance of the team, legal aspects and IP in the due diligence of an entrepreneurial firm. The venture team, mainly key personnel and the management team is important to acquirers, especially in terms of the willingness to be acquired and its competence. Also, having a good intellectual property strategy from the beginning is important, as it can be one of the show stoppers for the acquirer. Legal due diligence is also regarded as central, since changing suppliers and contracts might lead to synergies and economies of scale, which is important for the acquirer.

2.2 Venture capital and exit

Exit is the ultimate goal of the venture capitalist. Exit can be regarded as a process starting already in the pre-investment phase, where almost every decision made throughout the investment cycle has the potential to influence the final outcome of the exit. The following will give an overview of venture capital and exit uncovers variables occurring in pre-investment, post-investment and in exit phase which have a high influence on the exit outcome. Some variables are already defined in the pre-investment phase, while others have their highest influence during the post-investment phase or in the actual exit phase. To understand what variables influence the exit outcome, it is central to take a step back and consider the entire investment process. By focusing only on the exit phase means overlooking many of the determinants defining the future of the firm and subsequently the outcome of the exit.

How to exit and when to exit appear to be influenced by a multitude of variables. Some of the reasons that impact the exit are within the venture capitalists' control; however others, such as the market outlook, regional and global changes are not. No research covers the entire process, probably due to the complexity of the exit process combined with the sensitivity of the data involved. To be able to extract valuable information, certain limitations to content and scope needs to be set, and the focus limited to a defined particular subject. This chapter gives an overview of current research on venture capital and exit and aims to answer the following;

- What influences how and when to exit?
- What can affect the exit outcome?
- How can the venture capitalist affect the exit outcome?

2.2.1 What influences how to exit?

What type of exit and which is the preferred exit vehicle are both instrumental variables when venture capitalists exit their investments. What are the ways to exit a venture? For venture capital backed companies there are five principal exit vehicles: IPO's, trade sales, secondary sales, buybacks and write-offs. These five types of exit have quite different return potential and prestige associated to them. The two top-ranked exit vehicles are IPO or trade sale. These exit routes are regarded as preferred and successful exit routes. Several researchers look at secondary sale, buy-back and write-off as an exit failure, due to the fact that it limits the return on investment (Cumming and Johan, 2008; De Clercq et al., 2006; Wang and Sim, 2001).

Whether to choose an IPO or trade sale has been the focus for several researchers. (Brau et al., 2003; Giot and Schwienbacher, 2007; Hellmann, 2006; Yang et al., 2008). Most researchers state that an IPO is the preferred exit vehicle for both entrepreneur and VC (Gompers, 1996; Isaksson, 2000; Wall and Smith, 1997; Wang and Sim, 2001). While others, such as Schilit (1991) and Wright et al., (1990) point to the fact that a trade sale might actually be the

preferred exit route as it results in a higher valuation. The higher valuation is mainly due to the synergy that a potential acquirer might experience when buying the asset. If trade sale is preferred over an IPO it can be explained by the type of company and the state of the company at the time. To be prepared for stock exchange there are certain requirements that needs to be fulfilled, such as forecasting and predictability. Also IPO is not a good option for a one-product business. So based on the status of the companies the trade sale stands out as a favorable exit for startup technology companies in a growth phase with specialized unique technology.

Wall and Smith (1997) point to the fact that the extreme focus on IPO over trade sale, might lead European venture capitalists to miss out on profitable exits. Bascha and Walz (2001) add to the research by implying that there might be a distinction on what is the preferred vehicle for the VC versus what the entrepreneur might desire. And many ventures capitalist funds have a stated preferred exit vehicle (Isaksson, 2007). Therefore, the influence of the venture capitalist himself when choosing the exit vehicle for the investment cannot be disregarded. This is emphasized by several others (Isaksson, 2000; Schwienbacher, 2005; Wang and Sim, 2001) as there exist significant differences in exit behavior and the venture's geographic location influences the choice of exit vehicle. The behavior is related to which country the venture is operating in and is often regarded as a result of the institutional and legal factors of the specific market.

From the reported research findings, there is no general conclusion for the order of preference between the two top-ranked exit vehicles. But there are studies indicating which factors influence which exit vehicle will be employed. Brau et al. (2003) have looked at factors that will influence whether it's an IPO or a trade sale, and grouped their findings in four main categories, these are; industry characteristics, the role of market timing, the demands for funds by private firms, and deal specific factors. They also found a connection between the probability of a trade sale and; a high market-to-book and/or highly leveraged industry, being affiliated with the financial services sector, and where the deal involves greater liquidity for the selling insiders. In addition, they found a connection between the probability of an IPO and; high industry concentration, being affiliated with a high-tech industry, a high current cost of debt, a relatively hot IPO market, a large venture (in terms of total asset value), and a high insider percentage ownership. Poulsen and Stegemoller (2008) adds to this understanding and state that ventures with a high growth potential are more likely to go public, due to the fact that ventures with low growth potential do not meet the requirements of the public market. Schwienbacher (2008) stresses the importance of the innovation degree of the product or service offered. He states that a high degree of innovation makes it harder for potential acquirers to create a fit between their own organization and the target. The consequence being that it actually lowers the value for the acquirer, resulting in a decreased likelihood for a trade sale and an increased likelihood of an IPO.

In relation to exit vehicle there is a distinction worth mentioning between full and partial exit. In partial exits the venture capitalist holds on to an amount of his original holdings when the exit occurs, whereas in a full exit all of the VC's holdings are divested at the time of the exit

event (Cumming and MacIntosh, 2003). By first glance, partial exits seem counterintuitive; however the case is often the opposite. When venture capitalists retain a stake in the venture, it is not because they are forced to, but because they decide to. Retaining a stake in the venture will reduce the potential payoff to the VC without reducing the costs of the VC as an active investor. Nevertheless, Cumming and MacIntosh (2003) have looked at the determinants behind a full or a partial exit, and conclude that the main determinant is information asymmetry between the VC and the potential acquirer. Lin and Smith (1997) have further looked into cases of partial exit and found that if there is information about the venture that is difficult or impossible to make fully available to the interested parties. They conclude that when venture capitalists decide to retain a stake in the venture it is to illustrate that the investment is truly good, and they deliberately would like to send a signal to the market of the quality of the investment.

An important acknowledgment is realizing that the type of exit will affect time to exit. By some researchers an IPO is perceived as the fastest exit route. Espenlaub et al., (2009) argues that this is the reason why IPO's are regarded as the preferred exit route of many VC. However, this is a paradox, VCs are mainly driven by the return, but nevertheless they often keep a percentage of their shares. This means that an IPO actually needs to be regarded as a partial exit for the venture capitalist. The reason is that lock-up and contractual agreements often oblige the VC to hold on to a certain percentage of his shares.

In Europe more than 2000 European companies were exited and divestments from venture capital represented almost 50%, Figure 5 and 6. However, they only accounted for 9% of the amount divested by cost. The moist prominent exit routes for venture backed companies were trade sale, write off and sale to another private equity firm. For all buyout related exits, trade sale, sale to another PE firm and sale of quoted equity were the most prominent exit routes. IPO levels remained very low. Only 3 buyouts and 5 venture capital investments were able to take this exit route.

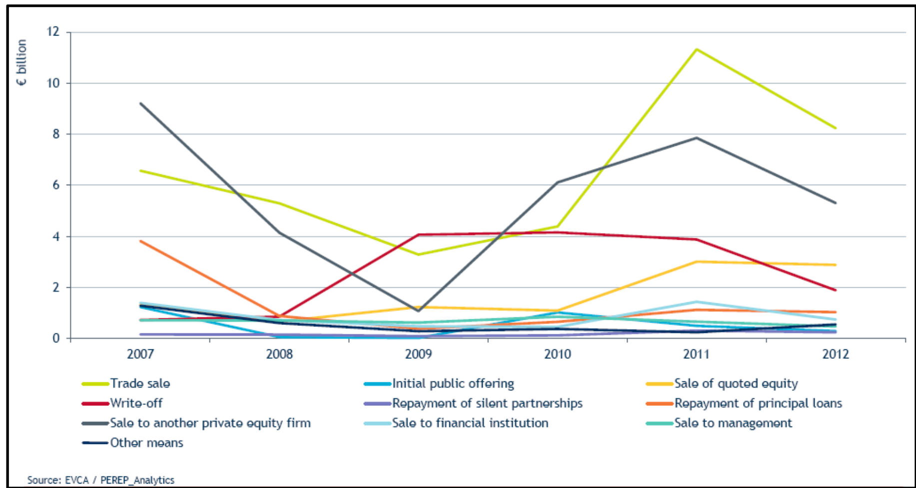


Figure 4. Divestments at cost by exit route by amount from 2007 to 2012 (EVCA, 2012).

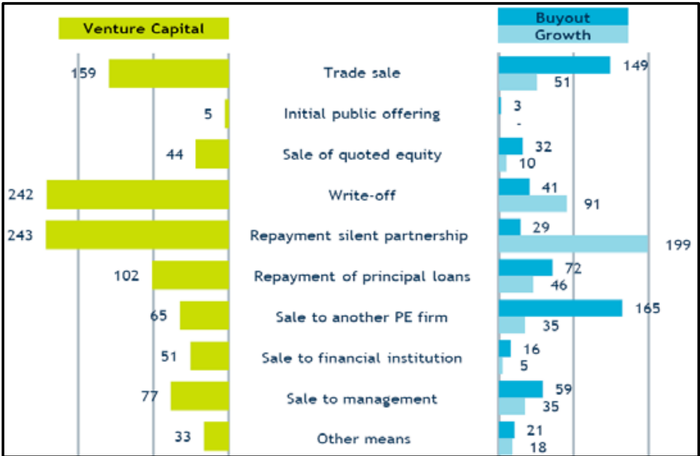


Figure 5. Divestments at cost by exit route by numbers for 2012 (EVCA, 2012).

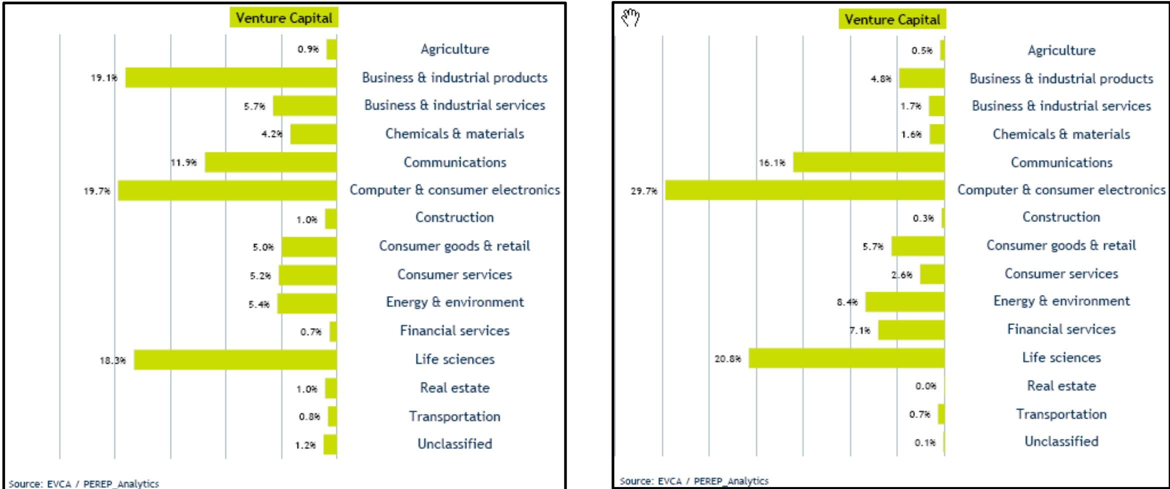


Figure 6. Divestments at cost by sector by a) numbers and b) amount for 2012. (EVCA, 2012)

2.2.3 What influences when to exit?

How does the time to exit influence the attractiveness of the investment? Douglas (1992) argue that time to exit is one of the key parameters in determining the attractiveness of an investment. In financial and economic theory there is an assumption that a shorter time to exit leads to a larger return on the investment and hence increases its attractiveness (Sahlman and Scherlis, 1988). However, this is not always the case. The cost of continued involvement has to be compared to a potential increased return on the investment. Adding value to the investment might lead to a concurrently larger return on the investment. The time to exit of a given portfolio venture appears to be influenced by a multitude of variables, some given by the external environment and others controlled to a certain degree by the VC. The following paragraphs review some of the motives behind when to exit.

The market place obviously plays an important role, where a hot market significantly shortens the time to exit (Giot and Schwienbacher, 2007; Rossetto, 2008; Shepherd and Zacharakis, 2001). There are two predominant explanations for this. One explanation is that a hot market is a liquid market and it is therefore easier to locate potential acquirers. The other predominant explanation is that a hot market offers potentially more good deals and the venture capitalist thus have an incentive to exit current investments, in order to free up financial and human capital for new investments. A hot market does not mean a hot price though; Rossetto (2008) makes an interesting observation regarding pricing of companies with venture capital backing; they are less likely to be underpriced during normal periods, however they seem to be underpriced during hot markets. This might be a consequence of wanting to access new capital.

Some studies argue that the company's geographical location and the country's legality might have an impact on possibilities for exit and the time to exit. Two studies suggest there is a relation between geography and time to exit; according to Shepherd and Zacharakis (2001) companies located in the West and Midwest of the U.S. have shorter times to exit than in the Northeast. They explain this by a stronger ecosystem in the West and Midwest, meaning that is the reason why that region has a higher birth rate of new organizations. Esbenlaub et al. (2009) support that there is a connection between geography and time to exit, by concluding that companies in the U.S. are exited faster than in the UK and the rest of the world. In addition some part of the literature suggests the legality in a country also is a determinant of exit possibilities (Cumming et al., 2006; Isaksson, 2000; Schwienbacher, 2005; Wang and Sim, 2001). Legality derives from different laws and finance factors, such as the judicial system, the rule of law, corruption, and shareholder rights, (La Porta et al., 1997; 1998; 2000). Some scholars argue that countries with better protection of shareholder rights have better developed equity markets, and therefore will high quality legal environments contribute to the rise of successful exit environments. Legality is also associated with governance structures, which in turn are positively related to exit (Cumming et al., 2006; Cumming and Johan, 2008).

De Clercq et al., (2006) and Zider, (1998) argue that the time to exit is a highly important variable in the venture capital exit process. They point out that VCs often have a time in mind for the exit, and therefore they pursue the ability to influence the timing of exit. As an example Lin and Smith (1997 argue that venture capital-backed companies seem to be taken public at an earlier stage than other companies in general. This illustrates how the VC himself is a factor influencing time to exit.

2.2.4 How can the venture capitalist affect the exit outcome?

2.2.4.1 Governance mechanisms

There is a risk associated with investing in early-stage ventures. The failure rate among these types of companies is higher than others. According to a study conducted by Zider (1998), as few as two out of ten ventures succeed. In order to cope with the associated risk, information asymmetry between the two parties, and a possible misalignment of interests, venture capitalists utilize different kinds of governance mechanisms. These governance mechanisms might influence the exit. How can different ways of controlling the venture affect the exit possibilities and the exit vehicle?

Governance mechanisms can be formal or informal. Often formal monitoring means are defined in term sheets or the terms in a stock agreement. The term sheet will likely state something about the following; control / veto rights, share classes, valuation, equity dilution. And typically the terms in the stock agreement regulate items such as; Tag-along, drag-along, first option, information and management rights, lock-up of shares, non-competition undertaking, right to vote and board members. In addition the VC will use other monitoring mechanisms to decrease the information asymmetry and enhance the control of their investment. To which extent governance mechanisms are used depend on the entrepreneur, the venture capitalist and the nature of the firm. More experienced entrepreneurs often have a track-record that reduces the risk for the VC, therefore the VC permit financing with less control rights, and more experienced VCs are more likely to use convertible securities (Cumming, 2008; Cumming and Johan, 2008). Also, VCs are more likely to use control rights in a venture that operates in a high-tech industry.

It is highly likely that the venture capitalist assumes a board position, as they normally take on at least one position on the board when investing. As noted by several scholars (Kaplan and Strömberg, 2003; Sahlman, 1990; Smith, 2005; Williams et al., 2006) a board position plays a crucial role in the development of the company and also in determining exit. Smith (2005) stresses this by arguing that the board is often the institution in the company that is authorized to initiate exit decisions. We can conclude that assuming a board position has larger impact on the exit, compared to not having a board position.

Cumming and Johan (2008) state that pre-planned trade sale exits have a higher likelihood of using convertible securities and a lower likelihood of using common equity. Hellman (2006) argues that convertible preferred securities allocate different cash flow rights for IPOs and

trade sales, subsequently influencing the exit. He also claims that the VC can have more cash flow rights in a trade sale if he has assumed an optimal contract for that. These studies might indicate that the use of preferred securities can affect the exit.

Venture capitalists can have veto rights, such as the right to liquidate. Liquidation rights are used in case the venture performance turns out extremely disappointing. VC will in such case utilize his rights to recover as much of their investment as possible (Sahlman, 1990; Smith, 2005). This means that VCs have the first claim of the venture's assets and technology (Zider, 1998). This show that veto rights can affect exit.

Staged financing is another used governance mechanism. The concept is that the portfolio company is only granted enough money to reach the next milestone, and subsequently the VC obtains control over the portfolio companies. By agreeing on milestones the venture capitalist and the new venture team set a plan, and if or when the milestones are reached, more money is likely to be invested. Staging the financing is a monitoring device (Gompers, 1995) and it gives the VC the option to abandon the project completely if it is performing badly (Sahlman, 1990). If the company is developing as planned, more money and resources is likely to be invested, consequently accelerating the exit. On the other hand; not reaching agreed milestones might lead to a divestment. This indicates that achievement of milestones accelerates exit for all exit routes (Giot and Schwienbacher, 2007).

2.2.4.2 Non-Financial Value-Adding

In addition to monitoring activities, venture capitalists spend much time on activities perceived to add value to the venture. Non-financial value adding by the venture capitalist is a debated issue. Several scholars see this in view of a resource dependency between the venture capitalist and the venture. According to Gorman and Sahlman (1989) most VCs spend more than half of their time actively involved with their portfolio companies. This includes both direct and indirect involvement. There has been much debate on whether or not these activities actually add value to the venture, and if venture capitalists add more than money. This central question is still much debated, and even if great efforts have been made to answer this question, the answer is still inconclusive (Barney et al., 1996). Some studies support the hypothesis that VCs add value (MacMillan et al., 1989; Sapienza, 1992), while others point in the opposite direction, or find no support for such a hypothesis at all (Busenitz et al., 2004). Maybe this is still a much debated issue due to the complexity of venture capital.

Nevertheless, while scholars have been unable to give a consistent answer to the question, the practitioners (venture capitalists) do spend a considerable time and effort on the portfolio companies, so they much believe they can add value to the venture. If we consider that they in fact add value, and that successful exits are dependent on successful ventures, it is evident that this influences the exit. It then becomes a question on to what degree they are successful, and how their value-adding activities can affects the exit outcome.

Several scholars (Ehrlich et al., 1994; Gorman and Sahlman, 1989; MacMillan et al., 1989; Sapienza et al., 1996) argue that the main value-adding activity is within financial and strategic matters. MacMillan et al. (1989) distinguish between four areas of involvement: development and operations, management selection, personnel management, and financial participation. Gorman and Sahlman (1989) and Zider (1998) add to this by arguing that venture capitalists also assist with developing business plans and recruitment. This may involve help in raising additional capital, providing strategic advice, and serving as a sounding board for the portfolio companies. Venture capitalists may therefore be involved in many aspects of developing the company. However, there are studies indicating that the entrepreneurs mainly seek help from investors when it comes to financial and recruitment matters (Ehrlich et al., 1994). This might indicate that the venture capitalist supply expertise that is in line with what the entrepreneur requests. Giot and Schwienbacher (2007) have conducted a study demonstrating that the degree of value-adding from the VC is positively linked to the time to exit.

The research also suggests that venture capitalists can add value in every stage of the companies' life cycles (Sapienza, 1992), that VCs with experience in the industry add more value than those who do not hold such experience (Sapienza et al., 1996). Research also suggests that the firm performance affect how the venture team assesses advice. There is a positive correlation between firm performance and the entrepreneur's evaluation of the value of VC involvement (Sapienza, 1992). Some are involved on a day-to-day operation (Gorman and Sahlman, 1989; MacMillan et al., 1989; Sapienza et al., 1996), while others may have a VC's attention only for an hour or two per week (Gorman and Sahlman, 1989; Zider, 1998). The amount of face-to-face interaction between the VC and the CEO and the number of hours put into each venture are determining factors of value added (Sapienza, 1992; Sapienza et al., 1996). There are at least two different explanations of this phenomenon. One is that venture performance influences the perception of the value that is added, and the other is that VCs actually do provide value, which is subsequently transferred into superior performance (Sapienza, 1992). However, Barney et al. (1996) found that the current performance of a portfolio company does not influence the assessment of the performance of VCs' advice.

It is obviously that the more value added to the venture, the higher is the probability of it surviving and growing to become a successful company. However, this is not straight forward, as there is a connection between the value added and an entrepreneurs' openness to advice. And this could be the reason why entrepreneurs mainly seek help to manage the financial aspects. Barney et al. (1996) confirms this by arguing that the success of value-adding is contingent on if the management team perceives that there is value in the advice. Following this line of thought, the demand for advice can be greater from entrepreneurs that are open to it. Hence, value-adding activities could have greater affect by having an open and demanding entrepreneur. This leads us to an interesting question and maybe one of the factors why the literature is so inconsistent on the value added hypothesis; do the venture teams in general see value in venture capitalists' advice and activities?

This question still remains unanswered. Nevertheless, it is a question of crucial importance; as adding value is something different than recognizing value, which is a subjective matter. If the venture team does not see value in advice provided, there is not much value added even if there are several studies concluding so.

2.2.4.3 Human and social capital and exit

The venture capitalist' human capital has been under investigation in several studies. The connection between the human capital and exit is touched by Dimov and Shepherd (2005). They explore to which degree human capital influences investment performance, and concluded that general human capital was associated with a higher likelihood of an IPO, while specific human capital reduced the probability of a bankruptcy. General human capital is defined as education within humanities and social sciences, while specific human capital is knowledge within management and law.

Since the venture capital investment process is a repeated game (Neus and Walz, 2005), it is very important for venture capitalists to take care of their reputation. Experienced VCs will have to consider how to retain their reputation, while younger VC have make sure they use every opportunity to build one. As a VC with a reputation it is important to sell the shares at a good price, also not overpriced. If secondary investors end up buying what they perceive to be overprized shares, it can affect the confidence in the VC and ruin their reputation, and consequently having an impact on their future investments (Lin and Smith, 1997). It is therefore of crucial importance to the VC to hold the fire until the true value of the company is revealed by the market. As a young VC it is extremely important to build a reputation. What better way than to have an IPO in your portfolio? Even though Gompers (1996) conclude that investments that are taken to the market too early will be underpriced, and that several researchers (Neus and Walz, 2005) argue that young VCs may have an incentive to underprice in order to gain a reputation, an IPO still sends a signal of the ability to pick good investments. Esbenlaub et al. (2009) supports this view by observing that young VCs hold their investments for a shorter period of time than their more experienced counterparts. The experienced VC can afford to take higher risk to increase gain.

The type of venture capitalist involved and his behavior is of great importance to the exit. Wall and Smith (1997) emphasize the importance of VC exit behavior by distinguishing between two types: the one who takes a minority stake in the company, has a long-term view of the investment, and has not planned a specific exit route the. This is the passive investor. On the other hand, there is the proactive investor. He plans exit from the investment date, is very motivated by cash, and gives the management incentives.

Relander et al. (1994) have also looked into VC's exit behavior, and suggest two different patterns. One knows as the path sketcher and the other as the opportunist. The path sketcher having a proactive attitude towards exit problems from the very start, planning potential exit opportunities even in pre-investment phase, and working actively on developing potential

exits during the entire post-investment phase. The opportunist, on the other hand, has a strong faith in his own management skills and in the potential of the investment target, making him confident that a profitable exit opportunity will develop when the time is right.

Graebner and Eisenhardt (2004) study shed some light on exit behavior by suggesting that the motivation for selling company mainly boils down to two factors; it's either due to strategic hurdles or strong personal motivation. If none of these factors are present, management will act in a discouraging way towards potential buyers, making a trade sale more difficult. Four factors driving the personal motivation of management were identified; fear of failure, stress, dilution risk, and financial gain. A strategic hurdle is defined as a non-incremental event in the company's development, such as raising funds, ramping up sales, hiring a new CEO or filling a strategic gap. Managers who experienced one or more of these factors were shown to have a high interest in being acquired. This view is partially supported by Petty et al. (1994), who found that the need for financing growth is a factor influencing the selling decision.

Venture capitalists bring financial and human capital to exit arena, but maybe even more important they bring their social capital. Certain players are connected to certain others, trust certain others, are obligated to support certain others, and are reliant on exchanging with certain others. These connections create the social capital of the individual, and every person's social capital accumulates to a social capital of the organization (Burt, 2000). As social capital is jointly owned and determined by the parties in the relationship, and in that way never owned by a single individual or organization. Consequently, in order to understand what might influence exit, it is of outmost importance to investigate the literature on exit and the social capital. Even though a minimal amount of studies have been performed focusing on this, some interesting results has been produced. When venture capitalists have invested in a company, they draw on their social capital to help the company succeed, using a network of service providers, such as; head hunters, patent lawyers, investment bankers, etc. (Hochberg et al., 2007). It is through this social capital "*… opportunities transform financial and human capital into profit"* (Burt, 2000). The player's network and the location of the player's contacts in the social structure give the player a competitive advantage in getting higher rates of return on investment (Burt, 2000), hence making these networks very important for both investor and entrepreneur in maximizing the rate of return.

Social capital has the potential to lower the information asymmetry. According to Gompers and Xuan (2009) social capital can have a direct influence on the problem of asymmetrical information. In their study of acquisitions of private companies by public acquirers, VCs can function as bridge builders between the acquiring firm and the target. They point to the following; the acquisition returns are significantly higher for transactions where the venture capital fund has a financing history with the acquirer. If the venture capitalist has strong social relationships with both the acquirer and the target, he can act as a bridge builder. He will have credibility and trust through his personal relationships, and assist to decrease any uncertainties or risk. This way the information asymmetry associated with the transaction is reduced for both parties. This in turn increases the likelihood of a successful acquisition. In situations

where the asymmetric information problem is especially predominant, this social capital is even more valuable.

Having a central position in the network does not only improve the access to deal flow. Well-networked VCs are found to perform better. They provide higher quality value-adding services to the ventures they invest in. According to Fisher and Pollock (2004) managers should carefully consider not just the reputational capital of supporters, but also their social capital. Hochberg et al. (2007) confirms this view by adding to the research that venture capitalists that are well networked at the time a fund is raised, enjoy significantly better fund performance. This is measured by the rate of successful portfolio exits over the next 10 years.

Another thing that might seem to add value is a syndication of venture capitalist. Syndication means augmented social capital, which provides a larger network, hence an increased possibility of finding potential buyers, and speed up the exit process. Several scholars confirm this point of view by concluding that syndication increases the knowledge reservoir and therefore decreases the time to exit (Esbenlaub et al., 2009; Widding, 2005)

Capron and Shen (2007) argue that a lack of visibility and lack of managerial ability have a negative influence on the value of assets. They also point out that a lack of negotiation skills and low acquisition experience influence negatively, suggesting acting carefully when negotiating psychological benefits at the expense of purchasing price. This is in line with the thoughts of Wall and Smith (1997), who suggest that a potential way to improve the exit process is to involve third-party intermediaries.

The literature on proximity emphasizes the importance of vicinity in the process of interaction, knowledge transfer, building trust, innovation and inter-organizational collaboration. Menzel (2008) argues that proximity promotes trust and understanding when complex and high-risk innovation activities are conducted. Building a company might in very high degree be about high risk innovation activities. Particularly relevant to inter-organizational collaboration are the dimensions of organizational, technological and geographical proximity (Knoben & Oerlemans, 2006).

Organizational proximity occurs through shared relationships within or between organizations (Boschma, 2005). This is a type of proximity which might include or shall aim to include; social, cognitive, institutional and cultural proximity (Knoben & Oerlemans, 2006). **Social proximity** is regarded as something that is generated through relationships between actors that are social. This kind of social interaction involves trust, friendship, kinship and experiences (Boschma, 2005). Social proximity is critical to collaboration (Ben Letaifa & Rabeau, 2013): In addition social proximity is also thought to facilitate effective communication (Maskell & Malmberg, 1999). Social proximity is often generated by past collaborations and repeated contact between partners, in which reputation and trust are created (Balland, 2011). When organizations attain social proximity they achieve extensive knowledge transfer and learning. The social interactions are viewed as a pre-condition for an organizations absorptive capacity because the interactions enable cooperative partners to

participate in a common context (Hotho, Becker- Ritterspach, & Sake-Helmhout, 2011). **Cognitive proximity** refers to the similarities between the ways actors perceive, interpret, understand and evaluate the world (Wuyts, Colombo, Dutta, & Nooteboom, 2005). It is also a means to facilitate effective communication between different parties. When actors have similar frames of reference, they are able to better manage effective communication and transfer knowledge (Knoben & Oerlemans, 2006), which are important determinants of R&D collaboration (Nooteboom, Van Haverbeke, Duysters, Gilsing, & van den Oord, 2007), and hence important for collaboration in general. The last two dimensions of organizational proximity are institutional proximity and cultural proximity. **Institutional proximity** says something about the institutional framework on a macro level (e.g., laws and norms) and that this affects how organizations coordinate their actions (Knoben & Oerlemans, 2006). C**ultural proximity** is when organizational cultures are similar. The organizations are consequently expected to interact more easily and with better results. This is due to those common interpretations and routines that allow the organizations to interpret and give meaning to actions without making all of these difficult interpretations explicit (Knoben & Oerlemans, 2006).

In addition technological and geographical proximity are regarded as particularly important for inter-organizational collaboration. **Technological proximity** means the parties have shared technological experiences and knowledge. It refers to the knowledge they gain from technologies, not to the technologies themselves (Knoben & Oerlemans, 2006). **Geographical proximity** is related to territorial, spatial, local or physical proximity. This leads to better performance on collaborations (Broekel & Boschma, 2012). Small geographical distances facilitate face-to-face interactions, which facilitates knowledge transfer and innovation (Knoben & Oerlemans, 2006). Physical presence always makes it easier and better to interact, and can positively influence mutual trust between cooperating partners by facilitating face-to-face interactions (Ponds, Van Oort, & Frenken, 2007).

2.3 Trust

One of the key outcomes of all types of proximity is that it enhances trust. This propinquity effect is a way to build trust in a relationship. There are three types of human relationships; personal, business and embedded relationships. Essential in any of these is trust. Trust is an expression of confidence in another person or group of people that you will not be put at risk, harmed, or injured by their actions (Axelrod, 1984). According to Shapiro, Sheppard and Cheraskin (1992) people form three major types of trust relationships with others; deterrence-based trust, knowledge-based trust and identification-based trust.

Deterrence-based trust means that people will follow through on what they promise because of threats or consequences. The consequences most often used are punishments, sanctions, incentives, rewards and legal implications. This kind of trust is often sustained by contracts, surveillance and punishment. There are two kinds of challenges with this type of trust; one is that they are expensive to develop and maintain (as they require monitoring), and the other fact is that they can backfire. The backfiring is based upon a concept popularly called reverse

psychology. Meaning that when people feel they are controlled by extrinsic motivations, such as sanctions and rewards, their intrinsic motivations is reduced. In other words; control might actually undermine the behaviors that such monitoring is intended to ensure. In other words; people often react negatively on surveillance.

Knowledge-based trust happens when a person have enough information to understand others and predict their behavior. This kind of trust often happens where there is information uncertainty or asymmetry, and the trust is a consequence or response to uncertainty. This type of trust increases the dependence and commitment among the parties.

The third type of trust is called **identification-based trust**. This type is grounded in complete empathy with another person's desires and intentions (Thompson, 2009). Thompson argues that this trust exist between people because each person understands, agrees with, empathizes with and takes on the other's values. They take them on due to an emotional connection between them, they adapt to each other's preferences and hence they act for each other.

There are two main routes to build trust in a relationship, either by the cognitive or the affective route. The cognitive route means to build trust based on rational and deliberate thoughts and considerations, while in the affective route trust is built based on intuition and emotions. Thompson (2009) summarizes four main ways to build trust by the cognitive route to be; 1) **transform personal conflict into task conflict**. She argues that personal conflict threatens relationships, whereas task conflict enhances relationships. 2) **Agree on a common goal or shared vision**. 3) **Capitalize on network connections** are all about finding a common node in their social network. 4) **Find a shared problem or a shared enemy**. And finally 5) **focus on the future**.

In addition to the cognitive ways to build trust, there are several psychological strategies to build trust. These mechanisms are different because people tend not to talk about these factors, but savvy negotiators know how to capitalize them intuitively. Thompson (2009) argues the ways to build trust by the affective route to be; 1) **The similarity-attraction effect**. This means that people, who are similar to each other, tend to like each other. Good negotiators increase their effectiveness by appearing similar to the other party. 2) **The mere exposure effect**. The more we are exposed to something – a person, object or idea – the more we like it. This tool is extremely powerful and crucial. It appears below our consciousness. 3) **The propinquity effect** underlines that physical presence has an impact on how close you feel related to others. 4) **The reciprocity principle** makes us feel obligated to return what others have offered or given to us. People feel upset and stressed if they have received a favor from another person without returning it, emphasizing that the feelings of indebtedness is very powerful. 5) **Small talk** has a dramatic impact on our liking and trust of others. Even short exchange lead people to develop trust. 6) **Flattery**; people are more likely to trust others who like them; this is at its strongest when people feel flattered on issues they somewhat feel insecure on. And finally, 6) **Self-disclosure** is when people make then selves vulnerable and share information about oneself to others.

Venture capital research on trust has used insight from procedural justice theory and emphasized the importance of fair treatment to achieve trust (Busenitz, 2004).

2.4 Game theory and Negotiation

Game theory is the study of strategic decision making. It is an umbrella term, for the logical side of decision science. It originates from rational choice theory, which can be traced centuries back, however it established itself and became an influential theory within the field on sociology in the 1960's, first introduced as exchange theory. It is based on a fundamental understanding that all social phenomena can be explained as; 1) a result of individual players' actions, and 2) human beings are rational beings basing their choices on a conscious cost-benefit analysis.

Rational choice theory argues that a major challenge for the individual player is that his or hers aspirations and comprehensions must be regarded in light of other rational players choices. And whether or not we succeed in carrying out our aspirations depends on what other actors do. The theory is therefore based on environments being strategic, not parametric. Rational choice theory preferred tool to comprehend this strategic interaction is game theory. Classical game theory was first introduced around world war two by the American mathematician John von Neumann and Austrian mathematician Oskar Morgenstern. Game theory is based on that two or more individually rational actors interact under the presumption that every players' success depends on the others players' strategies, and that all players knows this and must take it into consideration. Every player chose between a set of alternative strategies independent of each other. Some strategies are dominant. That means they are the strategy regardless of what the counterpart choses. Other strategies have a point of equilibrium, where none of the players have a reason to change strategy when they are revealed the strategy of the counterpart. Furthermore there are games with a solution and there are games without solution. In the games without a solution it can be impossible for the rational actor to manage to choose rational. If only the result of the game is better for at least one of the players without being worse for none of the others, the solution is optimal. While if there is no such result the solution is suboptimal.

Even though rational choice theory is probably the most worked up and systematic theory, it has only received a limited breakthrough in sociology. It have in sociological research been under a lot of criticism, mainly due to its fundamentals; viewing human choice as based on rational and logical fundamentals. It disregards the importance of norms and standards, and neglects human beings' sociality. While in sociology it is argued that to belong to a social community means to internalize the community's norms and thereby develop a social consciousness. Classical game theory bases its understanding of strategic interaction on rational isolated actors, that regardless of others and unrestrained of norms intervene strategic and instrumental with each other's.

The Prisoner's Dilemma has often been used in psychological, sociological, and economic research to understand situations where there is a social conflict between two or more interdependent actors. The core is that each individual actor is incentivized to act according to self-interest even though all actors are collectively better off if they cooperate. The Prisoners' Dilemma highlights the conflict between individual and collective rationality; defection is the

optimal choice for an individual who does not know his counterpart's strategy, however cooperation is collectively optimal for both parties.

Cable & Shane (1997) use prisoners' dilemma so understand and enlighten the interaction between venture capitalists and entrepreneurs. There work is based on an understanding that the success of startup businesses with venture capital backing, depends on a mutual cooperation between the venture capitalist and the entrepreneur. However, as this literature review demonstrates little is known about what makes these relationships work. Their research is founded in an understanding that knowledge specificity creates a division of labor and subsequently enhances the firm value. Knowledge specificity means that entrepreneurs and venture capitalists both specialize in different types of knowledge, allowing each other to exploit its comparative advantage. Given that cooperation is critical to the success of entrepreneur-venture capitalist relationships, one might argue that both parties will always cooperate. However, research indicates that cooperation is far from the standard (e.g., Sahlman, 1990). Rather, temptations are multiple and frequent for both entrepreneurs and venture capitalists. Nevertheless, as in Prisoner's Dilemma, it is through mutual cooperation that both parties can optimize return on investment. It is therefore essential to understanding how mutual cooperation between venture capitalists and entrepreneurs occurs.

Cable and Shane (1997) focus their discussion on what makes cooperative outcomes. As noted by both Sapienza and Korsgaard (1996) and Steier and Greenwood (1995), cooperative relationships between venture capitalists and entrepreneurs are necessary for the success of venture capital-backed start-ups. Cable and Shane (1997) present a conceptual model of entrepreneur-venture capitalist cooperation. Based on past research from the Prisoner's Dilemma research literature they introduce specific propositions concerning entrepreneurs' and venture capitalists' cooperation or defection strategies. They argue that **time, payoffs, communication, previous relationships, proximity, bonds, capital staging, generosity and penalties** effect the cooperation between the entrepreneur and the venture capitalist in the following way;

- The probability of cooperative entrepreneur-venture capitalist relationships increases with each party's perceived time pressure, this effect is greatest during the early stages of the relationship, and are greater for entrepreneurs than venture capitalists.
- The probability of cooperative entrepreneur-venture capitalist relationships increases with each party's perceptions of the payoffs from cooperation, the expected returns on cooperation are related to each ones venture ownership, the effect of expected returns from cooperation are greater for entrepreneurs than for venture capitalists.
- The probability of cooperative entrepreneur-venture capitalist relationships increases with the quality and frequency of their communications, the effects of communication on cooperation are greatest during the early stages of entrepreneur-venture capitalist relationships, and the effects of communication on cooperation are greater for venture capitalists than for entrepreneurs.
- The probability of cooperative entrepreneur-venture capitalist relationships increases when they share a previous positive social or business relationship, the effect of

previous positive social or business relationships on cooperation decisions is greater for entrepreneurs than for venture capitalists.

- The probability of cooperative entrepreneur-venture capitalist relationships increases as (a) demographic similarity, (b) work values congruence, and (c) perceived power equality between entrepreneurs and venture capitalists increase.
- The probability of cooperative entrepreneur-venture capitalist relationships increases if bonds are posted by the parties, and the effects of these bonds are greatest during the early stages of the entrepreneur-venture capitalist relationship.
- The probability of cooperative entrepreneur-venture capitalist relationships increases when capital payouts are administered and venture performance is evaluated in multiple stages.
- The probability of cooperative entrepreneur-venture capitalist relationships increases with the generosity shown by one party toward the other, and the effects of this are greatest during the early stages of the entrepreneur-venture capitalist relationship.
- The probability of cooperative entrepreneur-venture capitalist relationships increases when penalties against non-cooperative behavior are instituted, when venture capitalists have more penalties against non-cooperative behavior at their disposal, and are more likely to promote cooperation through penalties than are entrepreneurs.

To better understand the social interaction happening between actors it is necessary to expand the concept of rationality. Rhetoric and the modes of persuasion can enhance our understating on what can influence our decisions. The three modes of persuasion were first introduced by Aristotle and are commonly used to understand speakers. However, they are all about convincing the listener and can therefore be seen as important in a negotiation or a selling position. The three modes of persuasion are; ethos, pathos and logos. *Ethos* appeals to the authority or credibility of the presenter. It is important that the presenter convinces the audience, by being qualified to present or speak on the particular subject. *Pathos* appeals to the audience's emotions, Pathos is most effective when the author or speaker demonstrates agreement with an underlying value of the reader or listener. In addition, the speaker may use pathos to appeal to fear. *Logos* is a logical appeal or the simulation of it. It is normally used to describe facts and figures that support the speaker's claims or thesis. Together they are most powerful.

The field of negotiations is huge and work done in the field consists of researchers and practitioners and within a variety of disciplines (Eikens, 2013). The game theory is regarded as the foundation of the field. From literature reviews there are developments of the framework almost every decade since 40's and 50's, but the research on negotiations increased quite a lot around early 80's.

Several frameworks have been developed and the most recent approach is the 3D negotiation developed by Lax and Sebenius (2006). The first dimension is "the tactics", the second dimension being "the deal design", and the third dimension is "the set up". According to the study by Eikens et al (2013) the work is highly appraised by important contributors in the field such as Fisher, Ury and Raiffa. The approach is based on the developments form early

game theory and negotiations, and for more in depth review of literature on game and negotiations the study by Eikens et al (2013) is recommended.

According to the book there are three dimensions to any negotiation, but most people always focus on only one. By increasing the perspectives on a bargaining process the negotiator will be more successful. They have developed a cognitive frame and a comprehensive set of processes. When most people think of negotiation, they think of behavior, communication and tactics "at the table". It is acknowledge as a significant aspect of negotiations, however, it is only one of three dimensions and sometimes it is less important in terms of influence over the outcome. In the book they introduce what they describe as the three dimensions of negotiation which are divided into three steps; 1) Setup (3rd dimension), 2) Deal design (2nd dimension) and 3) At the table (1st dimension).

There are mainly two approaches to negotiations, it is win-lose or win-win approach and they have labelled these approaches as value claiming and value creating respectively. The win-win, expanding the pie, is also mentioned through the prisoner's dilemma above. But instead of restricting these approaches to the first dimension, to the tactics of negotiations, they apply these approaches also to its setup and deal design. Also they do use both selectively.

"At the end of the day, you want to create all possible value jointly, claim a full share of it, and prevent yourself from being exploited by a value claimer. " (Lax & Sebenius, 2006: p 205)

But there is always a tension between the actions needed for cooperation to create value and competition to claim value individually. And there is also always the possibility that the solution has an effect on future division of the "pie". To be a successful negotiator one should manage or overcome the tension and master both creating and claiming value, and also balance the two techniques effectively across all three dimensions.

"...at the very heart of the art and science of negotiation." (Lax & Sebenius, 2006: p 17)

Maximizing the chances of success in negotiation often involves setting up or altering the situation before the actual negotiation takes place so that the agreement you want looks desirable to the other side relative to their no-agreement alternatives. The setup happens away from the table before negotiations begin and involves an process of getting the right people to the table, in the right sequence, dealing with the right issues, by the right process, at the right time, and facing the right no-deal alternatives. They emphasize the importance of mapping of the stakeholders and to find out which approach to use towards each part, whatever situation you might be in when negotiating. To maximize the price in a trade sale it is important to make sure that the right buyers are at the table. The main thing here is to map the interest through various sources such as network, relationships, public information and advisors. Lax and Sebenius have structured this by seven questions which they hold to be very core. While executing in the 3rd dimension involves tactical skill, employing it effectively is more strategic than typical. The most effective negotiators often invest significant energy in 3rd dimension moves.

In the deal design dimension the focus is on creating value for both parties and "expanding the pie". While the set up happens "away from the table" and tactics are used "at the table", the deal is designed both at and away from the table. They introduce three aspects of a properly designed deal. The first is moving northeast, referring to a two-dimensional graph where axis represents the value for each participant. A technique to achieve this is combining differing interests which are relatively easy for one side to give and relatively valuable for the other to get ("dovetailing"). Another aspect is making lasting deals, referring to accommodate for predictable change to meet interests. The third aspect is negotiating in the spirit of the deal, referring to that what and how are clear to all parties. You might be right according to the actual wording, but if you violate the spirit of the deal you are likely to run into problems along the way. So even if properly set up, a poor deal design can doom negotiations before they start.

The first dimension is the process, and here tactics come in to play. Here you can claim value by using tactics (ethical or unethical) such as anchoring, reciprocity, cherry picking, good cop/bad cop, decoy, escalation, taking time outs, active listening, silent treatment and planted information (Eikens 2013; Anstensrud, 2012; Lax & Sebenius, 2006; Lundèn & Rosell, 2006; Fisher & Ury, 1981). In general, tactics should first aim to create value through joint problem solving, and then focus on claiming value in the expanded pie.

The 3 D negotiation is a continual process of auditing and strategy development across three dimensions and in the real world the boundaries between the dimensions are more unclear and a problem in one dimension may call for a solution in another. It expands the way of negotiations.

3 Methodology

This section covers an overview of the motivation for the research, methodological considerations and limitations for this thesis as a whole. The data sampling and analysis are also explained to provide trust in the data, and to validate the findings and nourish transferability.

3.1 Research setting and motivation

During the introduction to the various areas of academic research within Business development strategy, in addition to experience as entrepreneur and employees in a technology spin-out company, we have been intrigued by the fact that there seem to be a bit of a mystery related to the exit of such companies. This led us into the focus on how to successfully exit small medium sized technology enterprises through trade sale. As there has become more and more focus on start-up and spin-out companies as the route to economic growth worldwide there is a need for a better understanding on how these companies provide growth.

There are a huge number of studies performed over the years to evaluate key factors for how the venture backed companies develop and end up with a successful exit. Even though the studies are many and have variable focus there are several of the recent papers that have identified quite interesting gaps.

A recent literature study has been conducted where the findings reveal a lack of interest in the M&A literature on venture backed acquisitions (Sunde, 2012). Adding to this gap, the existing literature show limited types of perspectives, and studies examining how investors actually facilitate exits (that is, what they actually do) are virtually non- existent (Sørheim, 2012). The studies that has been done have looked into various factors, but there are not any studies focusing on the behavioral side of creating an exit. Research on how the exit actually is performed, what the various actors actually do, to achieve a successful exit, consequently providing economic growth, is an area in need for attention.

Focusing only on the exit phase means overlooking many of the determinants defining the future of the firm and subsequently the outcome of the exit, it is therefore central to take a step back and consider issues from the entire investment process. By combining the information of the value adding contributions of the VC with more concrete and detailed behavioral aspects, the findings will go beyond the various categories identified to matter. Out of five areas the VC contributed within, strategy and finance was perceived to matter the most (Berg-Utby, 2007) and this study aim to enlighten not just that it is done, but how it is implemented and by whom.

3.2 Research design

The exit phase has been studied by a lot of scholars, but there are no studies on the exit considering the behavioral side. This topic required a more in depth data collection and open questions to the objects. With limited research in the field, a qualitative approach was selected for this study. The strength of a qualitative approach is the ability to provide insight into complex relationships and processes through in-depth information (Baxter, 2008).

With the focus on combination of factors identified in the literature and the behavioral side where very little or no studies have been performed so far, and trying to answer the research questions on "how" in a certain context, it was obvious that this thesis had to be based on case study. The research questions are open and do not presume a certain set of assumptions to be proven prove(explanatory study), but rather see if there are findings that are more favorable, so it is obvious that it is exploratory in its form rather than explanatory (Stebbins, 2001). The study will concern economic activities of people and especially focus on behavior, historical and empirical data must be retrieved and the use of inductive reasoning will be utilized to verify any causal connection between the various factors.

The process of building theory from a case study research is relevant (Eisenhardt, 1989). This research approach is especially appropriate in new topic areas. The objective for the study was to identify the key factors to build and prepare for a successful exit through the life of the venture backed company. Research questions were defined to focus and to more easily select the cases. The objects in the study had variable degree of experience with exits and some had up to 50 case histories. Due to this opportunity the material is evaluated as a multi-case study, and will be used to build empirically valid theory (Yin, 2009). The study will require data collected for various participants and factors within one case and the design will therefore be an embedded multi-case study (Yin 2011, Hersen & Barlow 1976) in contrast to a holistic design which is less complex.

The main focus has been to investigate how to obtain a successful exit, so the cases are mainly selected to be able to predict how to achieve similar results (direct replications), but due to the experience of some informants in both successful and catastrophic trade sales, the propositions will also include anticipation for the contrast (theoretical replications).

3.3 Data sampling

The research design has been based on semi-structured interviews of participants in trade sales of venture backed technology startups. From our research question on how to build a company and prepare for an exit, we have sampled ten knowledgeable participants with experience from an exit and performed the interviews in the period from June to October. To reduce the information asymmetry and thereby the uncertainty in the perceived effect of actions and behavior the informant was chosen among VC, NVT and advisor. The informants

were contacted either directly or via individuals in our personal network and the interviews performed face-to- face, except for two that was performed by phone.

The questionnaire has been general and the experience of the object has varied from 1 to two cases for the entrepreneurs, while the venture capital and advisor objects have had numerous case histories as reference.

Due to the form of the study the informants were encouraged to describe the actual act that was performed in the various phases, by the various actors in the various cases. The interview guide was used to assure that all topics were covered, but the conversation was unstrained and based on the story telling of the informants. Additional questions were asked to cover all topics if left out or just briefly covered by the informant in the story.

The interviews were recorded and transcribed and individual statements were extracted to support the findings. Interviews conducted in Norwegian, was transcribed to Norwegian, however individual statements were translated by best effort by the authors.

The number of informants and cases are limited in number and data sampling is performed in a random sequence. An overview of informants and timing is given in Table 1.

Table 1 Overview of informants

Infor-mant	Case	Participated in pre-investment	Participated in post-investment	Participated in Exit Phase	Position	Industry
VC 1	1	X	X	X	Partner	Oil & Gas, IT, Health
VC 2	1	X	X	X	Partner	Oil & Gas, IT, Health
VC 3	Generic + 1	X	X	X	Partner	Oil & Gas, IT, Health
CVC 1	Generic	X	X	X	Investment director	Oil & gas
CVC 2	Generic + 1	X	X	X	Investment director	Oil & gas
BA/ Advisor	Generic		X	X	Self-employed PE Advisor	Oil & Gas, IT
NVT 1	2	X	X	X	Entrepreneur + CEO	Oil & Gas - hardware
NVT 2	Generic + 1	X	X	X	Entrepreneur + CEO	Oil & gas - service
NVT 3	Generic + 1		X	X	CEO	Software, Hardware
NVT 4	Generic + 1	X	X	X	CEO	Oil & gas, IT

The cases covered in this study had an exit by trade sale between 2007 and 2013. The interviews were performed in a random sequence, and the latter was more constructive as the first ones due to the authors increased insight of the methodology.

3.4 Data source and analysis

The source of data for this study is qualitative information from interviews of knowledgeable informants with experience with exit by trade sale either from NVT, VC or advisor position. Selection of the informants was done through personal network based on the context and the focus of the research questions. All the identified candidates were very willing to participate in the study and to share their experience and were surprisingly open with detailed information.

An interview guide was prepared, but not strictly followed in the sequence in the interview. The interviews conducted have had a broad approach, asking questions regarding building the company and preparing the company for an exit. The interviewees have focused on what does it take for a company to achieve a successful trade sale, and the questions have been related to pre-investment, post-investment and exit period. The objects were asked to retell the story how they experienced it from start to exit, and focus on actions or incidents of perceived importance. The interview guide was made by use of information from former studies where the same type of technique was used. The various categories of experts were interviewed in a random sequence. The interview guide was kept the same so all areas was covered by all informants.

We have conducted 10 interviews each between 1 and 2 hours with an average of 1 hour 20 minutes per interview and all together about 12 hours 30 minutes. All interviews were recorded and the transcripts from the interviews have resulted in a number of pages between 5 and 9 per interview and all together about 65 pages. Some information has also been given by e-mail and phone, but follow up conversations and e-mails are not included in the transcripts.

With very little literature and studies on the topic the analysis is highly exploratory. The background material for research directions was partly based on studies on activities performed in venture backed start up and growth companies and case study methodology in general. Since the informants experience represent different cases and also a variable number of trade sales they have experience from that varied from 1-3 for the entrepreneurs and 10-50 for the venture capitalists and advisor, the method used is a multiple and cross- case analysis.

In our interview guides we started out with the background material to get as much information as possible about the cases that have led to an exit, successful or failed. Going through these data we discovered that the identified factors for a successful exit were ongoing from pre-investment until the final agreements have been signed. The exit is not really final until all transactions agreed are executed which could mean even 1-3 years later.

Case study analysis does not have formalized routines procedures as other research methods (Yin 2011). A large amount of narrative text is difficult to analyze by software and either done by computer algorithm or manually there will have to be made codes for the analysis. So the first step is to systematically organize the data into hierarchical relationships, matrices or other arrays. In this study the information from the interviews are organized in a table, Appendix 2, sorted in which phase they occur, pre- or post-investment or exit-phase. Further analytical techniques have been described and the three most used are pattern matching, explanation building and time series analysis. Our strategy is to use explanatory analysis within the various cases and replication logic between the various cases.

In order to extract information from the interviews (narrative data) we have divided the statements of key activities or factors according to the phase they occur, if it belongs in the pre-investment, post investment or exit phase. The focus on the analysis is not on who is doing what, but on what is done and when to build the company and prepare for exit (explanatory). The statements are identified throughout the interview and allocated to the correct phase. During the analysis period the interview transcripts were read and reread to ensure that all similar or contrasting statements were identified and collected (Yin, 2009, Eisenhardt, 1989). The statements are presented for each informant in a table in Appendix 1.The information is further investigated (replication logic) to find activities or incidents that seem to be key for a successful exit or if lack of them can be linked to a failed trade sale. The factors mentioned by the majority of the informants identified as empirical findings are grouped together in key areas and presented by use of a process chart with building blocks in figure X. Figure 1 also picture how the areas relates to each other.

3.5 Limitations

There are various limitations to the study. The work for this thesis is conducted by Anne Dalager Dyrli and Guro Solem, when study was conducted employed in RESMAN AS, as VP Materials & Chemistry and Commercial Manager. We have not experienced an exit by trade sale so the process and actor was not familiar to us. Based on literature and guidance we found a gap in the field and a method to investigate. The background literature is acquired from some recent literature reviews performed by master students in the field covering various studies of venture capital, trade sale and spinout companies in addition to relevant literature from courses attended at NTNU. Studies that cover the same research questions and method are not identified. Due to our limited experience in the area and with academic research there might exist materials concerning this research field not reported here. But based on the methods chosen for the study and the sources for literature considered state of the art, this is not very likely.

An analysis of current theoretical framework and ten in-depth interviews with key people within entrepreneurship and private equity are the basis for the review and conclusions. There are limitations to the work, mainly due to the limited people interviewed and also the limited relevant academic work available. Since the trade sales were completed and the processes

belong to the past, there are a potential for retrospective bias. The interviews were performed based on open ended questions and the informants were asked to tell the story of the case. This method should improve the accuracy of the data.

The interview guides were prepared before the first interview was performed and not reviewed during the study. The questions or topics given here could induce informant bias and thereby control or limit the information obtained. Also a second interview could be more focused and thereby give more in depth or detailed information on the factors identified. As mentioned above the informants were asked to tell the story and if topics in the guide were not addressed, additional questions were asked within that topic.

The use of case study as research design have various types of analysis such as pattern matching, linking data to propositions, explanation building, time series analysis and replication logic. The handling of the data must be converged in an attempt to understand the overall case. It is also difficult to report findings in a concise manner due to the complex nature of this approach. Based on the focus and aim for the study the analysis is done by explanation building within cases and replication logic for the full multi-case study.

The number of cases is of course limited and how many cases that should be included is a question that is still a worry to this day (Small, 2009). For case studies there is no formulaic solution such as a power analysis to determine the needed sample size, but the general rule is that the more cases the greater confidence or certainty in a study's finding, and the fewer the less confidence.

From case studies to build theory or state propositions there are many aspects to consider and the selection of cases is important (Eisenhardt, 1989). One limitation is the context of the study with focus on oil and gas and venture backed spin-out companies which have successfully exited by trade sale. The sources used in the study are contacted through personal network and all are located in Europe, mostly in Norway. And all cases involve European companies, and mostly Norwegian. The selection was chosen in this context to fit the aim of this research study. Future research should evaluate if the propositions are valid across industries and geographic areas.

Some cases are common for several of the informants, both an entrepreneur and a VC, while other cases are described by only one informant. The lack of informants within a case reduces the validity of data triangulation. Several of the informants give general answers based on several, but limited number of, cases. The general information from a single informant on the topic could have potential bias regarding the informants recollection in time and self-evaluation of the various cases and sorting of information. For the discovery focused approach and the lack of research studies in the field the broad area to cover ant the limited time and resources available the design used are considered fit to obtain the aim of the thesis. Some of the informants were experienced in being interviewed in such a setting and also some of the cases has been used a source for studies earlier. This could have created bias as to the topic and focus in other studies, and thereby over time have amplified the perceived

significance of certain factors regards to others. The number of informants, their range of experience and the variation in position used to analysis are anticipated to increase validity.

Due to some sensitivity of the data collected, the informants and the cases are anonymized. The informants were presented this before the interviews to avoid that they withheld crucial information. This could be especially important for focus of this study where the action and behavior in the final negotiation is revealed and could influence future trade sales. The literature and also the findings in this study emphasize that even though not all information is disclosed, trust and honesty is very important in a trade sale situation. Together with the willingness to inform and the type of data collected, we have confidence that the data are accurate and solid within the context of the study.

External factors could have influenced on some of the cases due to the time period they were started and completed. We have not identified economic trends, nationally or globally, for the various cases, so there could be effects on the final result, time or value, caused by that. Several of the cases have a timeline that involves the last global recession, but very little focus on that in the stories told, so it is not investigated further. Other external factors could be governmental incentives and changes thereof, such as economic support as loan and tax reduction. Since the cases are concerned with companies in Norway as objects and large multinational companies, mostly American, as acquirers the variations between the cases are considered small. The fact could reduce the transferability.

Even though there are a large number of limitations to the data collected in this study, we are confident that the data collected within the time and resources available for the study give valuable information to the aim of the research.

3.6 Research Credibility and Transferability

The study is a qualitative research and seeks to understand the phenomena of exit by trade sale for venture backed companies. The definition of qualitative research is that findings are arrived from real-world settings where the phenomenon of interest occurs without manipulation of the researcher (Patton, 2001) and not by means of statistical procedures or other means of quantification (Strauss and Corbin, 1990). Several scholars are discussing in which terms one can evaluate qualitative results and while the terms reliability and validity are essential criterion for quality in quantitative paradigms, in qualitative paradigms terms such as credibility, confirm ability, consistency and transferability are among those regarded as essential criteria for quality (Lincoln & Guba, 1985). The concept of validity is described by a wide range of terms in qualitative studies (Winter 2000). If the validity or trustworthiness can be maximized or tested, the results will be more credible (Johnson, 1997) and may lead to generalizability which is suggested as the structure for both doing and documenting high quality qualitative research (Stenbacka 2001).

Triangulation has risen as an important methodological procedure in naturalistic and qualitative approaches to establish valid propositions where researchers search for convergence among multiple and different sources of information (Creswell & Miller, 2000).

The method of triangulation relevant for this study is single method data, theory and investigator triangulation. For some of the cases there were several informants so the statements could be confirmed. This was the case for several findings and the validity of those increased. Some data from the interviews were explained and interpreted by literature studies. Due to low number of cases and a lot of general input this is very valuable for the validity. In this thesis the two authors have separately looked at the information from the sources of data, so the findings have been obtained and interpreted by two different persons. Based on this methodology, we will argue that the research has a high internal validity.

4 Analysis and discussion

The qualitative study of this master thesis shed light on the black box of trade sales exit in venture capital small-middle sized technology companies. The ten interviews performed with experienced informants have given valuable input to the understanding of their contributions and the key factors from start to end. The empirical findings of the study aspire to give answers to the following research questions;

- What are the **key components to achieve** trade sale exit of venture capital backed small-medium sized technology companies?
- What are the **key methods to optimize** trade sale exit of venture capital backed small-medium sized technology companies?

The case study is driven by a discovery motive within the research field of venture capital. An overview of the empirical findings is given in Appendix 1. Based on the empirical findings, key components behind a trade sale exit of venture capital backed small medium sized technology enterprises have been established. The key drivers to achieve and optimize trade sale exit are found to be:

- **Competence, Team and Culture**
- **Network, Trust and Collaboration**
- **Strategic alignment with potential buyers**
- **Socialize the business**
- **Play the game**

The first three areas; competence and team, network and trust and obtaining a strategic alignment with potential buyers, are the characteristics the company needs to obtain in order to achieve a trade sale exit, while the latter two are pointing at how the company and participants behave to achieve the characteristics to ultimately optimize the exit outcome. Also the key areas are related to each other, so there are some interaction effects that will be mentioned in the respective sections.

The frame of reference shed light and puts the reader in a position to better understand the empirical findings. The venture capital literature looks at non-financial value added activities, especially within strategic matters, management selection, personnel management and recruitment and VC's industry experience and reputation. It enhances the understanding of the importance of getting the right competence and team, at the right time. This frame of reference, together with social and human capital literature shed light on the importance of network and trust.

In addition, the literature on trust and proximity shed light on how trust is built between people, but also between companies. It is significant as a background when analyzing that people and network counts. The theory on proximity is especially crucial to understand how collaborations, partnerships, and operational relationships are obtained and maintained.

Theory on cultural proximity also helps to understand the empirical findings regarding importance of culture.

Literature on psychological strategies to build trust, the modes of persuasion and game theory are all imperative to understand the empirical findings on how socializing the business and game is part of building and selling a company.

4.1 Components to achieve trade sale exit

The empirical findings strongly indicate that some areas are prerequisite to obtain a trade sale exit, while other areas make the seller optimize. The key components to achieve a trade sale are found to be; competence and team, network and trust and obtaining a strategic alignment with potential buyers. The following section will present the informants input on these areas and relate them to the frame of reference.

4.1.1 Competence, team and culture

When building a company with an ambition of exit within 5-7 years getting the right people on board counts. People drive the company, and to succeed that includes the ecosystem of people related to the company. For a venture capital backed SME this includes employees and management, but also shareholders and board members, as they are likely to be active owners. The empirical study conducted concludes that attaining the right competence, a multidisciplinary team and building a good company culture are prerequisites to achieve a trade sale exit. It emphasizes that people's competence, meaning their experience, expertise and skills count. And different phases acquire different competence and team. Having *"…the right team at the right time…"* is stressed by all in the study.

4.1.1.1 Competence

Competence is experience, expertise and skills. To have key people with the right set of competence, industry knowledge and a good reputation, make a difference. As part of the competence it is important to know what to build in house, core competence, and what and when it is better outsource to sub suppliers.

The empirical findings underline the very importance of having the right competence. Furthermore, the study indicates that the right competence is not easy to obtain and everyone describes it at personal and case by case dependent. What precisely is the right set of competence is, seem to vary from case to case, and from phase to phase. So understanding what the right competence means is not easy. Sapienza (1996) argues that VCs with experience in the industry add more value than those who do not hold such experience. The

study partly confirms Sapienza's view; several informants mention industry background as an important feature of right competence, while others don not emphasize relevant industry background. Consequently, the study indicates that the right competence is case to case to case dependent and it is a question having the right competence at the right time. Several informants suggest that there is a need for different personal qualifications for pre-, post- and exit phase. *"...only 2 out of 100 that can take a company from 0 to 15MNOK…."*. Several scholars (MacMillan et al., 1989; Gorman & Sahlman, 1989; Zider, 1989) emphasize that management selection; personnel selection and recruitment are important activities for the venture capitalists, however the literature does not contribute to understanding which personnel and management are needed at which time.

The empirical findings confirm the literature that for the venture capitalist having a good reputation makes a difference (Neus and Walz, 2005; Lin and Smith, 1997). One informant says *"It takes 10 Mill USD to make a good VC!"* meaning that their competence and reputation is obtained throughout time and not necessarily easily accessed. In addition, several informants underline the importance of a good reputation of several of the people involved in the business, indicating that a good reputation is beneficial not only for the VC, as suggested in the literature. This is a gap in the literature.

The study further indicates that keeping key personnel in the company, especially the entrepreneurs, is important. *"…the entrepreneur is important for the trade sale exit…"*. Some emphasize that entrepreneurial experience as an important asset. This is aligned with Cumming and Johan (2008). They argue that the experience of the entrepreneur is of value, and if they have a track record it can reduce the risk of the VC, decreasing the information asymmetry and need for governance mechanisms. However, in the study several emphasize that unexperienced entrepreneur also succeeds, suggesting that is a question of personal characteristics rather than relevant experience.

During the investment the VC always do risk evaluation including evaluate the entrepreneur. The study indicates that if investment decision was solely based on analysis, many of the successful cases would have been abandoned. Stating that; *"If we were to analyze the entrepreneurs they would fail"*. The study shows that the VC and other investors must have faith and trust in the venture team and use their gut feeling.

Also the competence of the advisor is suggested to be crucial. Several informants stress that having an advisor in the exit phase can make a difference. Some advisors are specialized in taking the company to an exit. They possess competence and network relevant to the preparation of the company. It is stressed by several of the interviewees that choosing the right advisor or intermediary are of outmost importance, as it can make an enormous difference, while others emphasize that the advisor is not that important. One informant has experienced that a trade sale failed due to the advisor and his lack of knowledge within the business. One advisor confirms this, also underlining the importance of taking care of your reputation by stating; *"The key thing is only taking on the projects you think you'll succeed with"*.

The study suggests that motivation is important. Various incentives should be used depending on the function. *"…cannot have a CFO that has no shares…"*. An option to buy shares for all employees is mentioned as a mean to ensure the right focus through the whole organization. Special attention to key personnel and entrepreneurs are pointed out. This could be very important when considering the exit where the key personnel and entrepreneurs are most likely included in the agreement as being locked to the company for a period after the trade sale. *"…the intellectual property, the key people, has walked out the door."*

The empirical findings confirms the literature that right competence is important, it adds to the theory suggesting that right competence is something that depends on phase and case. In addition to this, the study suggests that it is important to have the right set of competence in the team. For example an unexperienced entrepreneur can succeed together with the support of the competence and network of an experienced venture capitalist. It is the competence of the team together that is most valuable.

4.1.1.2 Team

Building a company for an exit is not a one man task, as it requires competence within a multitude of fields. The whole organization in a small company counts. So, having a multidisciplinary new venture team is of outmost importance. It is important that the team is recruited in order to complement each other. The study stresses that a multidisciplinary and complementary team is important, however not necessarily easy to obtain. Therefore, it is important to have a level of consciousness in a recruitment situation, as it is very normal to end up recruiting people that are alike us, *"…like people that are alike us, it's just the psychology of it…"*. Nevertheless, what might be right as a team in the early phase of building the company, is most likely not the right team for later phase. The requirements will most likely vary, and the study underlines the importance of having the right management at the right time is a prerequisite, stressing that the company needs another type of management when handling 5 employees and revenue accordingly, than a company of 50+ employees. One informant emphasizes the importance of the management team to be prepared before the exit process starts, and the use of psychometric methods to analyze and evaluate any change.

In addition to having the right in house team at the right time, the same goes for the board of directors. Several of the interviewees underline the importance of putting together a competent, aligned and multidisciplinary board of directors. The main owners are usually represented in the board, and professional and skilled owners in the board are crucial. The professional owners are more aware of the different roles they have and not to bring their shareholder baggage in to the board meetings. If the company have board members with different backgrounds they are likely to challenge the company more than if not. Also *"...have been out there, have been burned, and know what it takes to turn around…",* suggesting that is makes a difference if the board members have experience from starting a company.

It is not only important what that they possess different sets of formal background, but their work background also seems of value. However, as stressed by some of the interviewees

having a multidisciplinary board of directors does not occur as often as one wish. Most board members have a financial background, giving the CFO most challenges in the board room. Some board members have the right set of competence when building the company, while others are important when preparing the company for an exit. Some board members are very important during the pre-investment, making sure to bring along other possible owners and getting aligned with them. Other people's competence can be of crucial importance later in the investment phase, while the exit phase might need another set of experience, expertise and skills. Subsequently, having the right people with different competences on the board can make a difference. The requirements might change as the company develops, so expanding the team or changing some of the board members might be necessary. Sometimes bringing in an advisor as a board member or an advisor with a good reputation might be the solution.

Some scholars, such as Kaplan and Strömberg, (2003); Sahlman, (1990); Smith, (2005); Williams et al., (2006) argue that a board position plays a crucial role in the development of the company and also in determining exit. This is emphasized by Smith (2005) when arguing that the board is often the institution in the company that is authorized to initiate exit decisions. We can conclude that assuming a board position has larger impact on the exit, compared to not having a board position. However, there is a gap in the literature on what kind a multidisciplinary team means, suggesting which competence is needed in the management, the personnel and the board of directors of SME venture capital backed companies. There is also a gap on what kind of competence and team are needed for the different phases, as this could shed some light on what it means to have the right management at the right time. This study shed some light on it, however only suggesting it is case to case dependent.

4.1.1.3 Culture

Even if the management can and should be changed during the investment period, it does not mean that the company culture will be. Changing a company culture is likely to be one of the most challenging tasks, so establishing and maintaining an acknowledged company culture is of great importance. The entrepreneurs normally possess key competence and can be important culture bearers. So, in addition to their formal competence, they can possess important roles in the company being able to affect and or maintain the company culture.

Even though it is difficult to measure the company culture by potential acquirers, it is outlined by several to be important. One informant states the following on culture; *"It is absolutely crucial. Otherwise, what is the buyer buying?"* The background for the statement is that the buyer is not buying the management team since in a trade sale, more often than not, the management team go. He explains that for an acquisition to be successful the culture and key people are very important. One of the key reasons why acquisitions do not work is that the buyer has an incorrect notion that everything will be alright and before they know it intellectual property, the key people, have walked out the door. No scholars look at how the company culture in venture capital backed companies can affect building the company and

having a successful exit. This is a gap in the venture capital literature, as the literature on cultural proximity argues that when organizational cultures are similar, they are expected to interact more easily and with better results (Knoben & Oerlemans, 2006).

This section has emphasized the importance of having the right team at the right time, underlining that the team needs the right set of competence. They vary from case to case, and phase to phase, but still are of outmost importance on building and preparing the company for exit. The information extracted from the study show the importance of motivation of all employees by use of shareholder programs and a culture that work towards the same goal and to be solution oriented. As the management team is responsible to ensure that the necessary components are achieved, the management team is pointed out to be of importance at all times, but it is more the personal skills than the experience in the business or with trade sales that count.

4.1.2 Networks, trust and collaborations

In addition to right people with the right competence, the people also need to be connected to the right people. The study indicates that *"Our main contribution is our network, get connected to the right people"*. Network is essential to get access to right people when building the company, and when preparing the company for a trade sale exit.

The empirical finding definitely underlines social capital and network as of crucial importance when building and preparing a company for an exit. Several argues their network to be the core in their value added activities, and that the network make a difference when it comes to both building the company and when exiting it.

It is stressed that networks it's not just how many you know, nor who you know, but how you relate to them. The word trust and relationships are mentioned directly or indirectly by all informants in one or more contexts. Based on the statements given by the informants, the core of a well-established and proficient network is trust among its members. Due to the context with new disruptive technology and entrepreneurs there are a large number of decisions that rely on gut feeling and trust as opposed to analysis. Trust seems to be imperative to achieve a trade sale exit. A way to establish trust is to obtain collaborations or partnerships with potential buyers.

The empirical findings described below show that having a successful exit is linked network, trust and collaborations with potential buyers.

4.1.2.1 Network

To have a good network is not only important for the management or the board of directors. If the company in total, e.g. the employees, management, shareholders and stakeholders, possess a great set of networks it seems to have an influence and make a difference. All cases in the empirical study include a story on how someone's network influence core company decisions when building the company and ultimately exiting the company. This confirms Burt (2000), which argues that every person's social capital accumulates to a social capital of the organization; it is not something an individual or an organization possess. Burt (2007) also adds to this view arguing that the player's network and the location of the player's contacts in the social structure give them a competitive advantage. Consequently, networks play a crucial role in maximizing the rate of return. Hochberg et al. (2007) claims that when a venture capitalist have invested in a company they draw on their social capital, using a network of service providers to help the company succeed. The study indicates that this is not only valid for the venture capitalist, the study suggests that an experienced entrepreneur, CEO or management group and their network might possess the same capabilities, indicating that the total social capital of the organization is imperative for a trade sale.

The study indicates that network has been identified in all phases and by all roles in the company. In the pre-investment phase, network is important to get the right owner on board. VC's use their network to invite other VC's into the case and board, which are explained to improve the dynamics in the board room. During the post-investment phase the network is related to the degree the company is able to recruit the right people, it is often that someone's network led to recruitment of key people. Attaining the key people meaning the right set of owners and employees is stressed by all informants as crucial to achieve a trade sale. Convincing these key people to join the company either as shareholder, advisor, manager or employee is important, and it seems to be significantly related to who you know. This empirical study confirms the theory that there is a strong connection between the social capital of the venture capitalist and his or hers ability to pull the right set of people into the company. Also VCs want to have other VCs as partners to increase social capital. The study indicates that the venture capitalists' network is often used in pre-investment phase to get the right ownership structure set, having a positive effect on getting a competent, aligned and multidisciplinary board. In post-investment phase the VC seems to use their network to recruit key people with industry competence, get the right management group, to change CEO when necessary, increasing the ability to have a multidisciplinary management group, having the right management at the right time and being a key contributor to establishing operational relationships or collaboration with potential buyers. Finally the study shows that the VC's network is significant in the exit phase, as it increases the ability to get the right consultant, intermediary or broker when exit is approaching.

4.1.2.2 Trust

All interviewees in the study mention the significance of trust in relationships.

Some informants have*"…been in business for nearly 30 years, many of the people I mention are close friend…"*.It is important to have trust between employees and shareholders, especially between the board and the management. This trust is important when building the company, as it enhances the cooperation and assumingly more value is added to the asset. In the exit phase, the trust between the seller and the buyer is significant, and it can affect the exit outcome. One informant states that in order to have trust there*"…must be a partnership, a relation, a connection, and you have to know them…"*.

All exit processes include a due diligence. The due diligence comes in a variety of forms, and this study confirms this. Some of the due diligences interviewees have talked about are extensive. They last for months and include everything from HR, organization, IP, Market, Technology development and IP. In other cases the due diligence might just include finance and legal and be over in a few weeks. Even though due diligence are different and case to case dependent, all informants in this study states that the due diligence is for the acquirer is a way to confirm that the information they have received can be trusted. *"If they find something wrong, it will reduce the trust on what we say about the future."* Moreover, *"…the biggest buyout though, is telling everything."*

The empirical findings emphasize that trust is a prerequisite for these networks to be valuable, in the venture capital literature it seems like trust is regarded an obvious part of a network, and therefore not throughout investigated.

Trust is barely mentioned in the theory on venture capital, only the theory regarding the venture capitalist and social capital touch it. It argues that the certain players are connected to certain others, they trust certain others, are they are therefore obligated to support certain others. This empirical study shows that trust between all shareholders and stakeholders are an important asset when building a company, having an impact on exit. It argues that trust will decrease information asymmetry, enhance cooperation, increase the value added to the company and the absorptive capacity of the company will be remarkably greater. Trust is a prerequisite in all facets of building the company and making it exit ready. This study suggests that trust should be seen as of great importance when building a successful company and to be able to exit the company successfully. One critical relationship is the CEO and the owners and the board. The VC's make it a rule to know several of the employees in the company to reduce the risk of the CEO being a filter. This approach is not found to be addressed in the venture literature.

The relationships and trust theory helps us understand how trust in obtained and maintained in relationships. Deterrence-based trust (Thompson, 2009) is based on threats and consequences, and is likely the kind of trust a venture capitalist manage to establish with a new venture team if the information asymmetry is grand, and he decides to use several governance mechanisms to monitor the evolvement of the company. This study indicates that n networks that are filled

with trust are likely to be based on what Thompson (2009) call knowledge-based and / or identification-based trust. Knowledge-based being the kind of trust that occur when people can predict each other's behavior, it's a trust that increase the dependence and commitment among the parties. Well established networks are likely to be based on identification-based trust, a type of trust that is grounded in complete empathy. It's a kind of trust it takes time to achieve, and it exist between people that understands each other and share the same set of values. The study indicates that having this kind of network is an enormous asset. The venture capital literature has not looked into degree and type of trust in network, and how this can affect the network. This is a gap in the literature.

The literature on proximity can be a frame of reference to understand how vicinity is important to build trust, obtain knowledge transfer, increase interaction, and inter-organizational collaboration. Organizational proximity is something that occurs when there is a relationship within or between organizations (Boschma, 2005). This type of proximity shall aim to include; social, cognitive, institutional and cultural proximity. Social proximity is granted through actors that are social, cognitive refers to similarities between the ways actors perceive, interpret, understand and evaluate the world. Institutional proximity says something about the institutional framework, and cultural proximity is when cultures are alike. In addition there is geographical and technological proximity, the former related to physical proximity, while the latter refers to shared technological experiences and knowledge. The proximity literature, shed light on the importance network and collaborations between the company and the potential buyer.

4.1.2.3 Collaborations

"The really good sales start with having good relationships with 2-3 parties over time".

This study strongly indicates that establishing collaboration or partnership with potential acquirers is important. The study shows that relationships with potential buyers should take place when building the company, sometime during post-investment phase, at least prior to exit phase. When moving on to exit phase these relationships should have been there for some time. The findings show that collaborations and / or partnerships, such as an operational relationship, and / or a R&D collaboration with potential buyers have a great influence on exit. *"The ones that are not interested are the ones we have not worked with…"*

These collaborations are often seen as a proof of the company. Some interviewees argue operational relationship to be the highest level, while others mean that it is not critical what type of relations it is, but that it puts potential acquirers to know the company.

Having a good network helps the company to establish collaboration and / or partnership with potential acquires. It is also stated by informants that it is the personal network of an advisor, a VC or an employee that give access and enables the company to establish these relationships. Gompers & Yuan (2009) claim venture capitalists' social capital work as bridge

builders between the acquiring firm and the target. If the venture capitalist has strong relationships with potential buyers he will have the credibility and trust through his personal relationship, he will decrease uncertainties and risk and increase the likelihood of a successful acquisition. Furthermore, the study of Fisher and Pollock (2004) conclude that a well networked VC performs better as they provide higher quality value-adding services to the ventures they invest in. This literature shed light on the empirical finding, however the venture capital literature has not investigated how collaborations and / or partnerships with potential buyers is imperative for a trade sale exit. There is a gap in the literature to understand how these strategic alliances influence the exit.

4.1.3 Strategic alignment with potential buyers

The study shows that one of the key reasons behind a successful exit is being strategically aligned with potential buyers. If the company has a strategic fit with the buyer it can be integrated with the potential acquirer's strategy and add value. Most interviewees in the study emphasize the importance of having a technology that is strategically aligned with the acquirer, but several also mention that organizational alignment, having a similar culture and being easily integrated into their supply chain have a significance. The legal situation is important, such as partner agreement and employment contracts etc. If the company has some exclusive agreements with partners or customers, that could affect the list of potential buyers.

A VC informant mentioned that the strategic alignment is evaluated as part of the investment decision. However, one informant argues that it is *"…impossible to look 5-7 years into the future…"*. Obtaining strategic alignment is not *"not all about luck, but you have to be lucky"*. The empirical study illustrates that different people approach this differently. Some use a lot of time investing on how to be strategically aligned, they invest much desk time on following quarterly reports and read annual reports of the potential buyers, and they use their network and socialize the business, always trying to look for gaps in the potential acquirer's technology development and / or their market position. This information is gathered and used as a roadmap to adjust the company's strategy accordingly. In some cases it is all about being aligned with the potential buyer, not necessarily what is strategically best for building the company if exit was not the aim.

The empirical study leaves no doubt; being strategically aligned is a prerequisite for a successful trade sale. In addition to a strategic alignment, all interviewees underline that there are some elements that can lead to a higher multiple than others. The company should aim for a *"…must have this…"*.This is not easy to access, but it will put the company in a different position when it comes to the trade sale. As in the market place, there is a difference between "nice to have" and "need to have", or as several of the interviewees says; there is a difference between *"could, should and must"*. If a company has been able to develop and entered the market with something that is "a must", it can have a major impact on the value, and hence the price, of the company. Three areas are found to be of major importance to what the potential acquirer is willing to pay. These are;

- if the company possess something that can be a strategic enabler for the buyer
- if the company possess a future technology that can be perceived as a technology enabler or market opener
- if the company manage to be *"a pain in the backside on the buyer"*

Strategic enabler is argued to be when the company has a product, service or solution that can increase the buyer's sales on their own products, not just a "plug in" on their existing portfolio, but something that will increase their sales on already existing portfolio. It is the difference between "nice to have" and "need to have". Or the "must have", not the "could have" or "should have". If a product is a strategic enabler, or a differentiator in the market, it can increase revenue remarkably or make sure the buyer maintain their market share. There is an incredibly difference in what potential buyers would pay for something that is regarded as a strategic enabler, not just strategically aligned. It is a question of whether or not the company can be easily replaced with something else, because if not the buyer can be faced with loosing market shares if they don't purchase the company.

In some cases the acquired company possesses a new technology that is perceived by the buyer as a technology enabler or market opener. It is likely a new technology they can plug in to their existing portfolio and sell renewed product to existing customers. The market has already started to request this type of technology and not having it could lead to a market request for it. It could therefore be a potential show stopper for the growth if the company does not have it.

On the cases investigated in this study surprisingly competition is rarely mentioned as the main reason to buy a company. Rather it is because the technologies can take existing technologies to new levels, not due to direct competition. The informants in this study do not regard direct competition as a way to be perceived as strategically important. However there are a few cases mentioned, that is worth touching on, as it looks like it can affect the exit outcome. That is if the company has managed to be a competitor that becomes *"a pain in the backside on the buyer"*. The empirical study creates a link between people, network and trust and the ability to obtain strategic alignment. Several of the interviewees argue their network is their main source of information when it comes to what the marketplace consider as strategic enablers. Several scholars within the venture capital literature on non-financial value adding (Ehrlich et al., 1994; Gorman and Sahlman, 1989; MacMillan et al., 1989; Sapienza et al., 1996) argue that the main value-adding activity is within financial and strategic matters. And that higher valuation is mainly due to the synergy that a potential acquirer access when buying the asset. None of the literature reviewed look at how can people and network is used to attain strategic alignment. What strategic alignment means and how it is obtained is not investigated in the literature, this study contributes by stating something on what strategic alignment means, and how it is obtained.

The study also suggests that being a strategic enabler is a way to obtain an even higher multiple than what you achieve being strategically aligned. This differentiation is not looked at in the literature.

4.2 Methods to optimize trade sale exit

Furthermore, if the company has obtained the above mentioned areas, the empirical findings suggest there are ways and methods to optimize the trade sale. The two key methods that are regarded as a way to optimize the trade sale are; to socialize the business and to play a game. The following section further explains these two methods and relates them to the frame of reference.

4.2.1 Socializing the business

Socializing the business is all about spreading the word. On socializing events key people involved in the company talk about the company and technology. They make sure they are visible and aim to trigger the thoughts of the potential buyers that this is an interesting company with an important technology. To socialize the business is all about getting the potential buyers wanting to buy the company before they know they need it.

The interviewees all touch on the importance that the potential acquirer knows the company. As mentioned under network, having established some kind of a relationship with the potential buyers is crucial. In addition to this, key people use their network, socializing with key stakeholders and decision makers, ultimately aiming to position the company. All informants stress the importance of being at the right place at the right time, socializing the business, with a special focus on potential buyers. This is what is called “socializing the business”. The potential buyers are often identified early, and for all companies on the list, there should be a plan for how to relate to them. Several informants emphasize this directly or i0ndirectly as important for a successful trade sale. The term is explained by one informant as a methodology to position the company by making the company known toward potential buyers. Socializing the business means to let the industry know who you are and what you do. From a board level it is a very structured, what are the message. If there are existing relationships that is beneficial in the socializing process, they will be used. It is who knows who. As one informant states; *“Nobody buys something they’ve never heard of.”*

The VC works with this on a corporate level, but all levels are important. Venture capitalist work structured towards the corporate level of the potential buyers from early phase in the investment. They have meeting with M&A departments presenting their portfolio, looking at companies that might be of interest. However, as this study underlines; it is not the structures approach to the potential buyers that are of outmost importance, more importantly is socializing the business. One informant had an example of a company they had on their list of companies they were planning to dispose, and suddenly the CEO met someone, on a socializing event, that was interested and ended up with a successful exit. Socializing the business is all about using the network for all that its worth. It is talking to potential buyers, before they realize they are a buyer, spreading a consistent message.

The empirical study indicates that people who are socializing the business are people with an ability to use psychological strategies when building trust. They use the similarity –attraction effect, the mere exposure effect, the propinquity effect, the reciprocity principle, small talk, flattery and self-disclosure. They use it when socializing the business and they use the strategies when playing the final game.

4.2.2 Play the game

One of the elements that are pointed out by all informants is that; when the company has reached the exit phase, *"It's a strategic game"*. The term game covers everything from planning and preparing to actually performing the negotiations and finalizes the agreements for the trade sale.

Part of the game means that it is a competitive behavior of the interacting agents, in this case the buyer and the seller. Literature within the research field of negotiations has developed over decades and the three dimensional approach (Lax and Sebenius, 2006), that describes three dimensions to effective negotiation including an entrepreneurial process of getting the right context for the negotiations, supports the findings.

Preparations includes the former sections of ensuring a competent team and the ecosystem by use of the trusted network within and the socializing the business activities in many levels in the organization. Also the strategic fit with potential buyers for product and market, and to prepare win-win solutions and to agree on no-deal terms and alternatives is important to discuss before the process starts. This should be the tools to get the right people, at the right time and facing the right alternatives. Showing the importance of the preparations is among other the statements about the necessity of relationships and how important they are for the buyer to be interested. Several cases have had several types of relationships to several potential buyers, while other have only had one type with one potential buyer. In some cases an operational relationship can complicate the sale, especially if there is some kind of exclusivity deal agreed. All informants say that the company should try to avoid exclusivity deals, but in some cases it might be the only way to take the next step in the development. In these cases the company might be limited to a certain set of buyers when ready for an exit. It is not likely to buy a company with an exclusivity agreement with a competitor. And for big organizations buying a company with agreements with other companies can give operational challenges and hence be difficult to integrate. On the other hand the exclusivity itself leads the partner company to be in the best position to buy the company, as they know most about the company, and therefore should also be in a position to best target the market price. However, narrowing down the potential buyers list is something all want to avoid, as price is affected by whether or not you manage to create a sense of scarce commodity and have an auction. These strategic choices are part of the preparation and must be considered as one of the pieces in the game. One informant uses an analogy, *"It's a three dimensional chess game",* and the connection to game theory and negotiations is done by several of the informants. The analogy to three dimensional chess (or 3D chess), which was named that way to be more like modern war fare

(attach from several directions/dimensions), is used to explain the complexity of the situation. The study suggests that a game is played at various level and the players can move between the levels. This means that it is not just a negotiation between single points of contact in the organizations, or through one channel, but involves several levels in the organization and contact points.

The study outlines that creating a game is a way to optimize the exit outcome, however it is not easy. And having a triggering event is even more difficult, but if the buyers think this is a scarce commodity it can lead to feelings of fear, which can trigger a competitive negotiation. This is not straight forward and most likely done in many different ways, but what is clear from this study is that; an experienced negotiator knowing the game knows how. So, having the right people on board seems to be of outmost significance for this last stage in the investment cycle.

All informants seem to agree that opening up for auction is never a good idea. So, when exit is approaching you need to trigger the game. During various occasions people meet people, *"…someone has talked to each other…"*, and these meetings can in themselves by creating interest be the trigger for the potential buyer to make a phone call and thereby initiate the process. For this to optimize you have to make sure that other potential buyers will join and fear is a trigger for them to do so. A more controlled way to get the game started is to have a twin track approach. That means that the financial buyers are approached as a means to get to the industrial buyers. The financial buyers are approached because the company assumingly needs to raise money, the reason might be that they have something new to develop, a product they would like to spin out or just that they want to build the company big to take out its potential. This is put in an investment memo. At the same time the potential and preferred buyers are approached, thru network and connections, letting them know about the investment memo and that this might potentially take the company to the next level, but also letting them know that existing owners are flexible and that for the right price they will consider selling. This will lead them to think about buying, and maybe now is the best timing. If they wait the potential new financial investors will also want 3-5 times their money on just a few years, and the company might be of such a size that it's difficult to integrate.

When the game is triggered it is moving ahead. Then it is all about playing the game and getting several potential buyers interests, so that a bidding process can take place. All informants seem to stress the importance of the skills to handle this and describe it as, *"It is a game, and the good ones know how to play it!"*. A way to play the game is to use an electronic data room deliberately in the game. An electronic data room should be established from day one, but in reality it is something the companies start to work in the last two years prior to an exit, in some cases that means immediately after founding. The data room have different categories; finance, sale, HR and IP. When the potential buyers have been triggered you will grant them access to the data room, not opening all parts at the same time. In an electronic data room you can monitor activity, and you can deliberately open or close parts, make something visible only for some time. It can be used to deliberately confuse potential acquirers. In addition, if there is only one potential acquirer, using the data room make the

potential buyer think there are more buyers. You use the principle of the 3D chess game and move the pieces (documents) between the boards (the buyers).

The game is likely to affect the relationship between the main actors in a negative way. And since continuing with good relationships are of crucial importance to the NVT and the acquirer in the game, it is no surprise that the interviewees are occupied with how to avoid ending up in a bad light or loosing trust. One informant said that *"…the negotiations are done with lawyers and top management.…"*. In the study several of the interviewees emphasize that it is important to try to avoid being a principal in the negotiation if you will continue with the company after the transaction have taken place. By some the standard is to have the negotiating one level below the decision makers. The decision makers were involved, and they knew everything that was going on, but they were not to be in the negotiation room.

Another way to avoid the relationship being ruined is to use a broker. Using a broker by many is regarded as an expensive exercise, as they *"...come in and get 2-6%, while engineers worked for 10 years get less"*. But even if they not able to pull up the price that much it might be worth it. Because having used a broker is seen as beneficial when it comes to maintain a good relationships after the exit.

Another aspect of negotiations is that the cultural aspect has to be considered. It is important to understand the other part to avoid miscommunications. One informant experienced; *"They were discussing numbers and decimals, we were discussing principles"*. And as mentioned earlier this will depend on the culture in the company and the proximity of the parties. Literature on culture, proximity and negotiations support this.

Also the negotiating parts are dependent on the outcome to be good for both parties. If a VC or an advisor does a bad job they are less likely to be in the position to get another chance; "*…you only got one reputation…"*. The reputation is important to maintain the trust you have in the business. The buyers need to trust that *"…what you are selling them is what they are buying..."*. The aim of the negotiation is to get the right price and to give value to both seller and buyer. Agreements can be structured in many ways, and in a trade sale exit they often ends up with some kind of earn out model. This to keep intellectual property and key personnel as mentioned earlier. To increase the trust in and the credibility of the agreement for the buyer, the chairman of the board/BA or Consultant signs together with management.

Even though there are the best intentions to develop the product and market further, after the company is under control from the buyer, a lot of things can happen. Several of the entrepreneur informants had this experience and states *"Always be satisfied with what you get upfront, it might be all you get"*. Again the external factors mentioned above and also a different way of presenting numbers can make a difference.

The VC are concerned about the return on their investment and they will sell to the highest bidder even this is not the best strategic fit for the company. Strategic alignment is important to gain interest, but it is not possible to foresee the action from the acquirer. As one informant experienced *"We were surprised when we saw who the highest bidder was"*. Several external factors have been mentioned as reasons for the potential buyer not to join or to withdraw from

the process, such as other acquisitions that made them wait with more, new management or also new strategies. And again the importance in the negotiation position to always have a backup plan, the no-deal alternatives, is crucial. Some of the findings support the saying that the game varies case by case, however the findings show the importance of the preparation.

Having a good network helps the company to establish collaboration, partnership or an operation relationship with potential acquires. And as emphasized by several; the most successful exit seldom starts with someone knocking on the door. Nor do they start with employing a good broker and having a structured approach. There has to be a triggering event that is visible in the market that triggers the fear for not getting hold of the technology. When the process is started it is a three dimensional game to be played and the preparation is of major importance. You need to prepare the right setup to get the result you want.

4.3 Summary of findings, analysis and discussion

The qualitative study of this thesis shed light on the black box of trade sales exit in venture capital small-middle sized technology companies. The ten interviews performed with experienced informants have given valuable input to the understanding of their contributions, and the key drivers behind a successful trade sale exit. The empirical findings of the study have contributed to answering the research questions, by explaining what is found to be the key components to achieve a trade sale and what are the methods to optimize a trade sale.

The empirical findings strongly indicate that in order to achieve a trade sale exit the company needs to focus on getting the right competence and team at the right time, building a positive company culture, having trust in their networks, use them to get the right people, to establish adequate collaborations with potential buyers, and throughout the development of the company having a focus on obtaining strategic alignment with potential buyers. This is found to be a prerequisite for a trade sale, meaning that when these key components do not exist, trade sale does not seem to be an option.

Furthermore, this study has shown that if the company has developed these key components, there are ways and methods to optimize the trade sale. Key players need to socialize the business and play a game. To socialize the business is similar to the third dimension of 3D negotiations (Lax and Sebenius, 2006). Key players map the stakeholders and find out which approach to use towards each part, making sure you get the right buyers at the table, in the right sequence, dealing with the right issues, by the right process, at the right time, and facing the right no-deal alternatives. This study illustrates how this is done, by making sure the company obtains strategic collaborations and strategic alignment. Furthermore the study shows how socializing the business is done through network, relationships, public information and advisors. In addition to socializing the business, playing a game contributes to optimizing the exit outcome. This game is played by top management, VC and advisor. The parts are to make a setup, design the deal and to sit at the table. The building blocks with competent people with network and a strategic alignment are basis for the game and necessary to achieve

a successful exit. All elements have an impact on the result, so before the game starts the player need to make sure that all pieces are present and in place and shape. Each element is a piece in the play and to have all the pieces in place is a precondition. This study contributes to understanding which activities that are important and that together they make the basis for how to set up, design and perform the game. This study shows that in order to get the highest multiple it is imperative to trigger a competitive negotiation and have key players being experienced negotiators that knows how to play the game.

To build a company for a trade sale means building a company that aims to be part of another industrial company's strategy. All strategic decisions are therefore of imperative value, as they directly influence the ability to be bought or not. Almost at day one of you investment, you have to plan what the exit ought to be. There is no point saying "let's deal with that in the future", as you have to understand how you're going to exit. This study indicates that it is what is done in the preparation that determines whether the exit will be successful or not. The preparation starts as early as the start-up of the company. This study stresses that there are some key drivers behind a successful trade sale, and that these elements need to be profoundly considered throughout the whole development of the company. What to bring to the table; the preparation for the negotiations, is of outmost importance for the negotiation outcome.

The empirical findings are gathered and summarized in a table in Appendix 1. The table, which aims to demonstrate the empirical findings according to investment phase, shed light on what interviewees regard as important, and activities are divided in time according to the following three phases; pre-investment, post-investment and exit phase. Some activities start early while other quite late in the cycle and many activities are performed across the phases. The data in the table show that there are a range of activities, perspectives and challenges on how to build a company and how to prepare for an exit. The information in the table is numerous, so the data is further organized into key areas. Figure 7 below is based on the empirical findings in summarized in Appendix 1, and it aims to illustrate the most important key drivers, when they are conducted, who are involved parties and how they are related to each other.

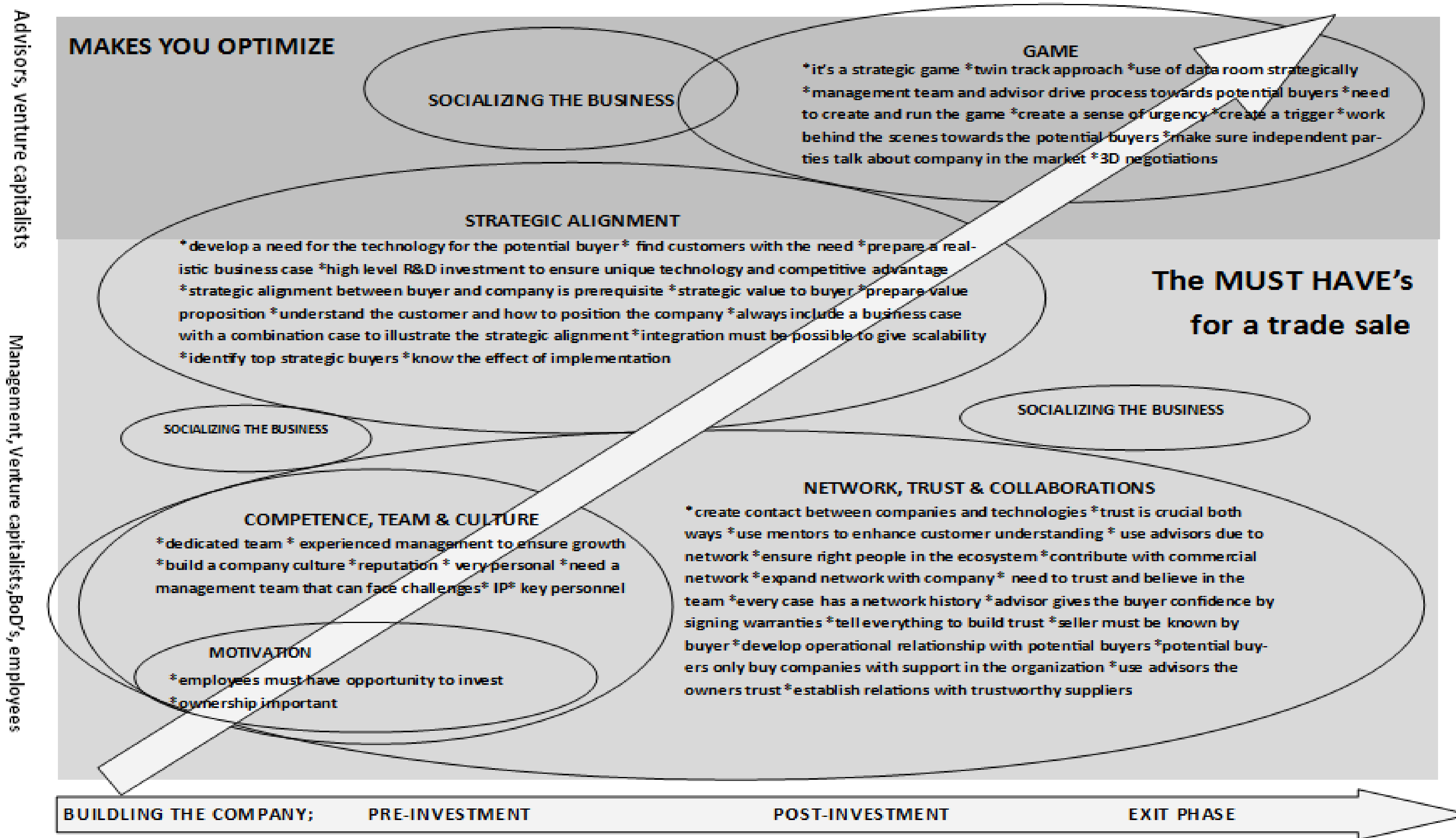
The elements are organized in terms of timeline and sequence. In the figure the y-axis illustrates what takes place when building and developing the company. **Competence, team, culture, network, trust and collaborations** are found to be prerequisites when building a company and exiting it successfully. To have the right competence, team and culture is regarded as of crucial importance even from the very beginning, and the findings show that it remains important throughout the whole development of the company. **Network, trust and collaborations** are also imperative drivers; however they are regarded as especially significant in post-investment phase and maybe even more so the closer the company gets to an exit. To be aware of the importance and to work towards obtaining a **strategic alignment** with a potential buyer, must be regarded as important even from the very beginning of building the company. This focus on obtaining a strategic fit must take place in pre-investment and post-investment phase, and it must be obtained prior to entering into the exit phase.

If the company has a these elements, including a strategic alignment with potential buyers, **socializing the business and playing a game** optimize the outcome. These two methods are of crucial importance when the company is approaching exit and is in the exit phase. To "socialize the business", meaning to relate to potential buyers is found to be important throughout the whole development of the company, but get increasingly important towards the end.

The arrow across the figure illustrate that these elements can be regarded as building block for a successful exit. They are interrelated and that competence, team, network and trust must be in place prior to working on strategic alignment, and that these areas together must be in place to play the game. The game is described as a 3D game and to position the company and to prepare the play is just as important to play. They are related and interdependent; however certain some must take place prior to others.

In addition the fact that some elements are key components to achieve trade sale exit, while others makes you optimize, Figure 7 illustrates that competence, team, culture, network, trust and collaboration, together with strategic alignment are regarded as a must have, while playing a game and socializing the business is regarded as what makes you optimize. The figure also indicates who are involved at the different areas, all stakeholders being part of the fundamental elements, while the game and socializing the business is mainly conducted by key players, normally VCs or Advisors.

Figure 7. Key elements for a successful trade sale exit



5 Conclusion and Implications

The purpose of this thesis was to shed some light on the black box of trade sale exit of venture capital backed small medium sized technology companies. The ambition was to better understand what the key drivers for a successful trade sale exit are.

The two research questions that have been addressed are;

- What are the key components to achieve trade sale exit of venture capital backed small-medium sized technology companies?
- What are the key methods to optimize trade sale exit of venture capital backed small-medium sized technology companies?

5.1 Conclusion

The qualitative exploratory study has showed that there are certain elements, the key components that are imperative to achieve a trade sale exit. These are;

- **Competence, Team and Culture**
- **Network, Trust and Collaboration**
- **Strategic alignment with potential buyers**

Moreover, the study points at two key working methods or behavior that can make the trade sale exit optimal, these are;

- **Socialize the business**
- **Play the game**

Given a good set of people, complimentary and experienced, the development of a technology that is disruptive and different, with a high potential in the market, that is at least enhancing or better enabling, and have the IP in place is probably the most important things to focus on to build the company for an exit. To actually optimize the value you need to gain interest from potential buyers along the way, hence there is a need for socializing the business. In addition, there is a need for a triggering event to initiate the sale process, and key players that are good negotiators knowing how to play the game.

5.2 Implications for practitioners

This study stresses some key components to achieve a trade sale exit. Some of them take place already in pre- and post-investment phase, while others in the exit phase. Due to that the various components will need variable focus from various actors. The findings have shed light on some important components especially for the investor and the entrepreneur. But also for advisors for trade sale exits there are findings of importance.

Among the key components there is one component that stands out as part of all the others special and for all actors, trust. To have success you need to have faith and trust in the people you work with.

"…..birds of a feather flock together"

To optimize there are some key methods identified that have implications for all actors. The preparation toward the exit is not a stochastic game, it is strategic and as Louis Pasteur's statement "Chance comes to a prepared mind!". The preparation and identifying the alternatives are just as important as the negotiation "at the table".

Also the options for the deal are something that has implications for all practitioners. The trade sale is not only about the money for the sale. It is about expanding the pie.

In addition to the general implications there are elements that are more important for the investor and others for the entrepreneur to be aware of and such co.

5.2.1 Implications for entrepreneurs

In addition to the general implications given above, entrepreneurs need to take a closer look at these elements and implications for their prioritization. The findings show key components that give significant implications to entrepreneurs of venture backed small start-up companies. In the pre-investment phase the plan for the journey should be addressed and analyzed for alternatives. The VC's primary goal is exit. This study shows that this is not always communicated by the investor to the entrepreneur. The entrepreneur should take this into consideration, knowing that potential buyers are identified from day one. All entrepreneur informants stated that there was not much focus on exit in the pre-investment phase opposed to that VC's actually state that it is of major focus to them. Entrepreneurs are often unexperienced and unfamiliar to the VC concept and therefore not aware of the high focus at that time. Their focus is on the technology and to get it going. The study shows that entrepreneur would benefit from having better grasp on what are the key elements that will ensure a successful trade sale exit. This helps the entrepreneur to be aligned with VCs, potentially increasing cooperation and decreasing information asymmetry. For the entrepreneur the important components are to;

- Secure skilled and experienced owners
- Be aware of their exit strategies
- Build a competent team, culture and strategic alliances
- Ensure the motivation of all employees
- Reduce market risk and assure strategic fit with potential buyers

The Entrepreneur is important in the trade sale as key personnel, intellectual property, and as culture bearers. Also the entrepreneurial experience is important asset and should encourage them to innovate.

5.2.2 Implications for investors

In addition to the general implications given above, just as for entrepreneurs the investors need to take a closer look at these elements and implications for their prioritization. The importance or focus on the various components changes with case and phase, but there are some key features such as competent and motivated team with key people that are important to build and maintain. Incentives such as shareholder programs are mentioned as one important component. The entrepreneur and key personnel are important to keep in The VC often has a large network and experienced investors have over time developed the content necessary to give legitimacy to the company. As empirical findings show, and the literature confirm, having a good reputation makes a difference. To gain such experience and reputation a young investor should make sure to get training among the best. The network can also be useful to attract the competence needed during the various phases. The study shows that VCs often are the most conscious part, especially when entrepreneurs are unexperienced, when it comes to directing the company towards obtaining a strategic alignment with potential buyers. They should put a greater emphasis on the importance of obtaining a collaboration or partnership with the potential buyers, and if needed increase the awareness of the entrepreneur in this topic. Investors should in general pay attention to collaborations and partnership, and consider if and how operational relationships can be obtained and maintained. The study indicates that this can increase the list of potential buyers, get the company more strategically tuned and consequently increase the price and optimize the sale.

Most of these key components are identified in earlier studies, but as they are important and prerequisite they are not enough to optimize. To do so there are certain methods that needs to be utilized. Investors should know the importance of socializing the business, and make engagement plans with potential buyers from the very beginning of establishing the company, involving different roles in the company, making sure the relationships are established and maintained at different levels (Lax& Sebenius, 2006). An important feature besides being visible in the market is to build trust in the technology and the company. Here we found consensus between all informants. Furthermore, investors should be aware that gaining interest is not enough to get the best possible price; they need to make sure they have the right people playing the game and prepare no-deal alternatives. Even though you are well prepared,

factors outside your, or anyone's, control could kick in and stop the process either for one or all buyers. The study indicates that network can give invaluable access, and that a good negotiator knows how to play the game. Hence, both choosing the right or the wrong advisor can make a difference. A finding is the study is the importance of it, but how to choose the right advisor for the case is topic for future research.

5.2.3 Implications for advisors

The advisor role is one of the actors involved in the preparations and the negotiations for the final trade sale. As for investors and entrepreneurs the competence and experience are found to be important. The advisors should therefore be very careful to build such qualities. The main focus is to facilitate the trade sale with all stages that implies. To build the reputation the advisor should be very particular when they take on such an engagement. They only have one reputation. Also there are certain findings that they should spend enough time close to the company to be able to be on top of the game. They need to spend time to be aligned with the company and to ensure that the necessary preparations are done.

In addition to the choice of advisors for investors, the advisors role and behavior have not been main focus point in the study and will be interesting for future research.

5.3 Limitations and Future research

This study have opened up the black box of trade sale exit, by shedding light on how to achieve a trade sale exit and how to optimize a trade sale exit. There is little, if any, research material on this, and it is necessary to take a closer look if these findings are applicable and found to be the case in broader studies.

Future research could increase understanding by addressing some of the limitations identified in the study. To be able to extract information the study has some limitations and some of these are limitations of the methodology. This is addressed in chapter 3.5. The identified limitations to this study may give valuable input to future research in the field, such as increased number of cases, several sources within each case and repeated interviews to enhance reproducibility and to focus. For a case study, the general challenge is to have the right number of cases to be able to create credible data. Depending on the approach and focus in the study either an increased number of cases and/or increased number of sources within one case and by carefully selecting the design provide greater credibility and confidence in the data. Several sources within a case will increase the ability to triangulate. The cases in this study, due to the general feedback from most investors, are many and spread in time. The focus in this study was not the external local or global factors, but several of the informants mentioned delay in the process, also initiation of such, due to such as oil price drop and recession. Earlier studies did not find direct effect on trade sale from the global economy, but

to reduce the effect of such one could aim to look at exit performed almost simultaneously. Also more recent cases will reduce the memory bias, so a surveillance in the market and collect the opportunities as they come would increase credibility. As there are emotions involved during the whole process this is especially important for the input form the entrepreneur informants.

Future research should investigate the concept "successful trade sale". The concept successful trade sale is in this study regarded as a subjective matter. Future studies should define what a successful trade sale is. This should be conducted with assistance from various practitioners in the field, including investors, entrepreneurs, managers and advisors. Thereafter, researchers should investigate which components are related to what is defined a success. Future research should aim at including activities and components from the whole investment cycle, not only post-investment or exit phase. This study demonstrates that there is a need to take a closer look at and enhance our understanding on how competence, team, culture, network, trust and collaborations are related to a successful trade sale. In addition, it is imperative to better grasp if there are any methods, as suggested in this study, which are positively related to optimizing the trade sale.

Future researchers should investigate what competence and team is needed for the different phases of building a company for a trade sale exit. This study suggest that some people hold the qualifications for taking a company 50-200 employees, while other can take the company from 20-50, and only a few can start up the company and take it from 1-20 employees. Future studies should look into if there are any traits and features that are common to the managers in the different phases.

Future research should look at company culture in venture capital backed companies and how it can affect building the company and having a successful exit. The research needs to establish a frame of reference on what a "good culture" is; how it is obtained and maintained. And thereafter investigate how the culture influences the development of the company and consequently the options for a trade sale.

Future researchers should investigate relationships between stakeholders over the investment period. This study indicates that "it takes a village to build a company", and that the relationships between all the stakeholders are important. Cable and Shane (1997) use prisoners' dilemma so understand and enlighten the interaction between venture capitalists and entrepreneurs, focusing their discussion on what make cooperative outcomes. The research is limited in its applicability to this study, due to only taking VC and entrepreneur into consideration, and only looking at what makes good cooperation, not investigating how enhanced cooperation influence the trade sale. Further studies should expand on Cable & Shane's (1997) work, including more roles in the ecosystem of the company, and look at if and how good cooperation between several can influence the value of the company. This can shed some light on the importance of trust in networks.

Future researchers should investigate collaborations and partnerships and strategic alignment as a prerequisite for a trade sale. Research should investigate if collaborations and partnerships are related to increasing the list of potential buyers and if it is a source to obtain strategic alignment. In addition, this study indicates there are various ways to obtain strategic alignments. Future research should take a closer look at what are the ways to obtain strategic alignment.

Future research should investigate the impact of the third dimension of 3D negotiation. It should look into how this approach have valuable methodology for developing companies for trade sale, especially focusing on the importance of preparations for the negotiations, which in these type of companies starts when establishing the company.

Future research should look into how and when to trigger a trade sale. Some methods are mentioned in this study such as the twin track approach or in some way create fear of loss and thereby initiate a process. In any case is important to ensure a large enough list of potential buyers. Additionally, it should look into ways of playing a game and if there are any methods to ensure the seller optimizes the price.

Future research should look more into the value of an advisor. There are many statements in the findings that support that the good ones know how to play the game and that a bad choice could end in a catastrophe. The experience and trust of an advisor could be worth it for several reasons. Research should investigate if this is a personal skill, e.g. not so scalable, or if it is a methodology and can be learned

This thesis strongly suggest that there are many unknowns to trade sale exit of venture capital backed companies, and that future research in the field is needed to enhance our understanding, and ultimately increase the probability of better trade sale exits.

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Appendices

Appendix 1 Summary of interviews

The table below is a summary of all the interviews. The table illustrates key elements mentioned by the interviewees with experience from a variety of cases. In the table they are placed according to which phase they were conducted.

#	Pre investment phase	Post investment phase	Exit phase
VC1	- Technology risk, NO market risk - Oil and gas – that's where trade occurs and at good prices - Technologists must resign from their positions and start 100% in the company - Recruitment of the NVT important	- Focus in the market, small company cannot do everything - Recruit for company and the board; get competence from market and production - Prepare long list of potential buyers and initiate "marketing" of the company to them	- Selection of advisor important – must have references from trade sale in this market and price level - Data room to avoid information asymmetry - Surprised by who made the largest indicative bids – but there were identified synergies - Mark-up on our share purchase agreement to evaluate – evaluate if high bid has many reasons for too high price and the totality, such as how it was structured with payments and earn outs - Before exclusive arrangements – evaluate their comments to avoid to be locked - Parallel to the exit process- strong focus on delivering operationally.
CVC1	- Focus on technology that are important for the mother company - no long term ownership - Must be a probability for exit, trade or IPO - has the mandate to go in very early - have risk adjusted rate of return - NVT must have ownership - Wish to have 20-30% ownership, maybe less in the US due to exposure. Do not want to be the big one together with many small ones!	- Create contact between the company and technologists in Statoil to ensure the focus on the right technology development strategy, testing in field and to help the company to be attractive to Statoil's purchasing department - Recruit for every phase – build the NVT to fit the different phases company and board - Trust is crucial, both ways. If you lose this there is no return! - Mentors outside Statoil to adjust their understanding of the customer more - Important to know the effect of implementation fo the technology, pros and cons etc. - Competitor surveillance	- Use of advisor in some cases, but it depends on number of potential buyers; they could have network into the buyers, but have experienced that it could be a waste of time and money also. - Timing is as quick as possible and at a good price, but no pressure on timing from our side - If another investor comes in late, and the company stagnate, they would like to wait until they can get a better price even we are satisfied - Try to choose the optimal timing, when it is most interesting for the buyer - Timing could be decided by the fact that the company needs new owners with large support on various fields to survive - Finance and contracts are important - Heated discussions and hostility among individuals may occur - Historic data necessary to build the BC - Buyers competitor advantage due to acquiring differentiating technology - Strategic alignment – "må bare ha det"-type of attitude - Earn out - more than 50% of cases has one kind of mechanism

#	Pre investment phase	Post investment phase	Exit phase
VC2	- We look for companies with revenue >25MNOK now, internationally venture, but in the Nordic region this is growth. - We identify the top strategic buyers during DD in the investment process - Helps the company through transaction	- Ensure enough and right type of capital at all times - Ensure the right people in the ecosystem around the company - Contribute with commercial network (used to avoid pitfalls) - Focus - Share programs started when the company is matured enough to low risk of emissions - Want to know several in the company – CEO is a dangerous filter	- Hire advisors - Build a trustworthy business case - Understanding of the customer and how to position the company - Integration must be possible to give scalability - Responsibility and IP is important - Potentially showstopper if IP not on track - Always include a combination case even though the buyer gets pissed since they want to own that part
CVC2	- Must defend based on gain for users in mother company; operational savings or increased production etc. - Will prefer to have other owners with the same objectives	- Recruitment of NVT - Financing since the costs tend to increase and revenue decrease from the goals - IP strategy - Internal control - Agreements with users, ref exclusive for user within oil and gas	- Participate in choice of advisor; they need to have a reputation, experience - Data room preparation – the primary source in the DD - Contribute to the teaser and memorandum - Behind the scenes towards the potential buyers - Involved when the agreements are made, transaction agreement.
VC3	- Prioritize the not-strategic technologies - Early stage - Technology and market risks - Invest in stages - Need to trust and believe in the team - Evaluation is based on experience and not pure analytics - Need understanding of the Technology must fit strategies of typical trace buyers	- Build the team and adjust to various phases - Must be open for new potential buyers - IP and IP strategy – wording in patents! - Prepare potential buyers by marketing cooperation etc. - Important to have seniors in the process - DD on the NVT to handle demanding situations - CFO important position - Board of directors- work with CEO several times a day - Contributes to strategy, financing, organization and technology development - Market verification	- Choice of advisor are crucial – experienced catastrophic result - Prepare value proposition! - CFO important - Accountant must be experienced. Will never use a small next door officce - Balance on track – especially important with production in various countries - Strategic value to the buyer - Synergies in business model - Independent parties that talk about our technology ion the market. - weak point in patent and also in financial number was discovered by us (seller) during DD and immediately communicated to buyer, but destroyed the advantage we had over the buyer and our possibility to increase the price

#	Pre investment phase	Post investment phase	Exit phase
BA/ Advisor	-you have to plan what the exit ought to be. - data room from day one, definitely in pre exit phase -	- it is what you do in the preparation that determines whether the exit will be successful or not. - build the management team to deliver the plan - Experienced management - secure steady growth; too fast is a runaway car - build a company culture - socializing the business; strategic, operational or competitive - alignment ; spread the same message - find the need, must buyer -private equity concentrates on CFO due to knowledge, but CTO and whole management team are important - compensation should be market driven - key behavior in board; not bring shareholder baggage	- advisors reputation - require a lot of desk research work from advisor; about 5 times more than with the company - join only potential success - in situ advisor - consultant invited by the owners of the companies, and get them exit ready - Average appointment time is 14-18 months - very personal so not scalable – every case has a "network history" -The core part of the discipline is transacting the business in the exit. -use predefined techniques or methodologies; Management, Product, Market and Exit. - Focused exit methodology - need to have management team that can face challenges - join the management in signing reps and warranties – that gives the buyer confidence - tell everything - It's a strategic game - three dimensional chess game. - twin track approach; investment memo to raise money and simultaneously address 4-5 potential buyers - use data room strategically
CEO/ NVT 1	- expect exit , but not always decided route - unique technology - dedicated team	- dedicated NVT and time - must be known to the potential buyer - VC contributed to BC - high level of R&D investments to keep competitive advantage - revenue or soft funding to finance the R&D - develop the ecosystem around the company with experienced people within market and technology - Network and connections - motivation of NVT in many cases not the money - important that the employees have the same opportunity to invest; that is invest according to ability and desire - IP more important last years	- Starts with someone showing interest in the technology and market - strategic alignment between the buyer and the company are important - management team and advisor drive the process towards the potential buyers - earn-out model is only valuable if the company can continue to have control and provided investments needed etc. - evaluate earn-out against the strategy the buyer has for the company - identify non-core and separate for other owners - huge amount of data to be provided - term sheet with price and price model ready before DD started - exit timing influenced by global trends

#	Pre investment phase	Post investment phase	Exit phase
CEO / NVT 2	- exit was discussed, but type not decided - network and connections	- competent team in all facilities - ownership among employees - professional owners - build professional management team - global footprint - not focus on IP - network and connections	- competent and experienced advisor - structured process - failed due to market failure - buyers called - wanted to grow, but needed financing for the growth - Strategic alignment - use of data room - needed verification that what we told them were true - customer contracts and numbers for revenue - changed management style after buyout - "must have" from acquirer - short process, but the buyer had been following the company
CEO / NVT 3	- shareholder agreements with drag-along terms - exit was discussed	- develop operational relationship with potential buyer(s) - develop need for the technology for potential buyer - identify synergies - share agreements with employees; can buy according to ability and desire - experienced management - build management team to fit the various phases - important to keep the entrepreneurs in the company - terms and conditions on delivery agreements - avoid exclusive agreements	- Strategic alignment - acquire only companies known and with support in the organization - fear of losing advantage to other competitors - controlled process - advisor - it is a game; need a trigger to start - the owners decide if they accept the bid and financial evaluation is always the key factor - the acquirer that know the most about the company will probably have the highest bid - advisors require 2-6% for 2 months work, but necessary if management are to continue cooperate inside the new organization - advisor will reduce time required for the NVT and keep focus on sales - sales prognosis and IP - use advisors and consultants the owners trust
CEO/ NVT 4	- new nothing about the exit at this time	- independent trustworthy and professional suppliers - create ecosystem through network - find customers with need - build the team - prepare a realistic BC - socializing the business; market the technology and products - solid management team - IP strategy was thoroughly prepared and placed in data-room - operational relationship with potential buyer - outsourcing of time demanding activities such as production and assembly	- advisor - structured process; teaser-indicative bids-management presentations-bid-preferred buyer-exclusivity-DD-SPA-signing and closing - need a management team that are trustworthy and have the ability to deliver - timing obvious when we got large contracts - do not have the internal experience to learn as a company that has been around for 20 years - a professional buyer is the best, even if foreign - long list and NDA's for the advisor to present the teaser - need to create and run the game - exit bonus for new employees -strategic alignment - create sense of urgency; meeting dynamics and "the game" - weak point in IP agreements was spotted, but got no consequences

Appendix 2 Interview guide entrepreneur

Background information about interviewee

Name / position/ experience

The case

From investment to exit

- Industry
- Market outlook
- Owner structure
- Exit strategy

Exit process

- Exit decision timing
    - When was timing on exit decided? Pre-defined?
    - Who initiated? Seller or buyer?
    - Disagreements between NVT and VC on timing?
    - Preferred exit route? Disagreement between NVT and VC?
    - Was it the preferred timing on exit?
- VC level of involvement
    - Trade sale in mind?
    - Adapt or build a great company?
    - Exit strategy influence activities?
    - How did VC contribute in the pre-exit phase?
        - Most important activities?
        - Least important activities?
    - Role of the VC in the DD process?
        - Bridge builder?
        - NVT – VC relationship?
- Potential acquirer's
    - How many?
    - Active search or contacted? How was relationship established and maintained?
    - Prior contact?
    - NVT perception of the potential acquirers
    - Preferred acquirer?

- Perception of the DD process
    - Degree on NVT –acquirer contact
    - Quality of data / reporting?

    - Efficiency of the process?
    - Any red flags? Any no or no-go's / show stoppers in the DD?
    - Areas with special attention;
        - NVT?
        - Financial? Historic or future outlook?
        - Legal? Contracts with suppliers?
        - Organization?
        - HR?
        - Market?
        - Strategic alignment?
        - IP?
        - IT?
        - Did the acquirer build a business case progressing the firm's future?
- Motivation
    - Compensation structure
    - Financial incentive
    - Trade sale dependent?
    - Rich or king?
- Areas of responsibility (advisor/NVT / VC)
    - Price negotiations
    - Providing data / reporting

Appendix 3 Interview guide VC/ BA

Background information about interviewee

Name / position/ experience

The case

From investment to exit

- Rationale (factors evaluated) for investment?
- Market outlook
- Terms (owners structure, equity share, syndication, board control)
- Pre-planned exit strategy
    - Communicated?
- Broker or VC driven exit process?
- Core value for the acquirer?

Venture capitalist and non-financial value adding

- Level of involvement
    - One or more from VC? Alternating/changing contact?
- Contribution in addition to money?
    - Most important activities
    - Least important activities
    - Specific situations that shaped the future of the company?
        - National or global trends? Random or chased/controlled?
- Disagreements
    - Related to the trade sale context?
    - Specific situations?
- General decision process (VC – NVT)
- Trade sale exit in mind?
    - Exit strategy influence on activities?
    - Adapt or build a great company?
- Compensation structure
    - Financial incentive?
    - Trade sale dependent?
- Monitoring structures
    - Corporate governance (internal control, handling of risk)

Exit process

- Broker / VC driven process
- Exit decision timing
    - When was timing on exit decided? Pre-defined? Preferred?
    - Who initiated? Seller or buyer?
    - Disagreements between NVT and VC on timing?
    - Preferred exit route? Disagreement between NVT and VC?
    - Time of communication to NVT?
    - Was it the preferred timing for exit?
- NVT motivation?
    - Compensation structure, financial incentive, trade sale dependent?
- Role of the VC in the DD process?
        - Bridge builder?
        - NVT – VC relationship?
- Potential acquirer
    - Degree of active marketing of the firm? How?
    - How many potential?
    - Active search or contacted? How was relationship established and maintained?
    - Prior relationship? VC- acquirer? NVT – acquirer(coop. or former employees etc.)?
    - NVT perception of the potential acquirers
    - NVT - Preferred acquirer?
- Areas of responsibility (advisor/NVT / VC)
    - Price negotiations
    - Providing data / reporting
- the DD process
    - Degree on NVT –acquirer contact
    - Quality of data / reporting?
    - Efficiency in the process?
    - Any red flags? Any no or no-go's / show stoppers in the DD?
    - Field visits?
    - Change in NVT perception of the preferred acquirer
    - Areas with special attention;
        - NVT?
        - Financial? Historic or future outlook?
        - Legal? Contracts with suppliers? Employee contracts?
        - Organization? Culture? HR?
        - Market? Strategic alignment?
        - IP?
        - IT?
        - Did the acquirer build a business case progressing the firm's future?
    - Did the acquirer build a business case progressing the firm's future?
    - Field visits
    - Change in NVT perception of preferred acquirer?