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Venture Capital Trade Sale Exits

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Oppgavetekst/Problembeskrivelse The purpose of this thesis is to gain a better understanding of issues related to performance with regards to venture capital trade sale exits. The students will perform a qualitative multiple case study covering a series of previously performed venture capital trade sale exits.	
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Kandidatene skal ha *individuell* bedømmelse ☐
Kandidatene skal ha *felles* bedømmelse ☒

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Problem Description

The purpose of this thesis is to gain a better understanding of issues related to performance with regards to venture capital trade sale exits.

The students will perform a qualitative multiple case study covering a series of previously performed venture capital trade sale exits.

Assignment given: January 17th, 2011.

Supervisor: Associate Professor dr. polit. Roger Sørheim, IØT, NTNU.

Preface

This written work is the master's thesis of the authors, who currently pursue a Master of Science degree in Industrial Economics and Technology Management at the Norwegian University of Science and Technology (NTNU). The thesis is prepared as the final report in the course TIØ4945 – Innovation and Entrepreneurship, Master Thesis.

The main components of this study are the theoretical findings from a literature review conducted during the fall of 2010 and the empirical findings from a multiple-case study conducted during the spring of 2011. Since the cases contain sensitive information, all case companies and affiliated actors are made anonymous. For the same reason, interview transcripts are not included in this thesis.

The authors wish to thank their academic supervisor, Associate Professor dr. polit. Roger Sørheim at the Department of Industrial Economics and Technology Management, NTNU. Dr. Sørheim's passion for the research field, invaluable comments and guidance, and dedication to our success have been instrumental for the end result.

Moreover, thanks go to other individuals that have helped refine and improve the thesis. Specifically, the authors want to thank Professor Peter R. Russo and Adjunct Professor Barry Horwitz, both at Boston University School of Management, and Professor Andrew Zacharakis at Babson College, for their introductions to interviewees. The authors have also appreciated the inspiring environment of the NTNU School of Entrepreneurship. Finally, the authors would like to thank the interviewees for participating in the multiple-case study presented in this thesis. These participants have given the authors invaluable insights in the field of study.

This thesis undoubtedly still contains defects, but these are mainly due to the authors' own limitations.

Trondheim, May 27th, 2011.

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Abstract

Even though venture capital trade sale exits are the most common and successful exit vehicle, historically most academic attention has been given to IPO exits. This thesis takes the first steps towards opening the black box that is trade sale exits. The thesis is paper-based, and the main academic contributions belong to the four papers appended. This document opens with an introduction to the field of study as well as overall reflections in order to offer the reader a contextual background. Paper one is based on a literature review, while paper two through four are based on an inductive multiple-case study covering 19 venture capital trade sale exits from Norway and the U.S.

Paper one conducts an extensive literature review of venture capital exits in general, leading up to the development of a model denoted "The Road to Venture Capital Exit". This model identifies the variables that influence the exit process in the different phases, and describes how these variables influence the exit process.

Paper two explores the relation between pre-planned exit strategies and value-adding, and suggests the existence of two different venture capitalist mindsets; the Tailor and the Architect. The Tailor uses exit possibilities as an addition to traditional deal evaluation criteria, has a pre-planned exit strategy, and adds value with exit in mind. The Architect does not use exit possibilities as an evaluation criteria, and adds value in a more general manner.

Paper three examines the relationship between the venture capitalist and the entrepreneur during the trade sale exit process, finding that this relationship is characterized more by consensus and cooperation than by conflict and defection. Further, it is found that four factors influence the relationship during the exit process, and are determining for the conflict level. These factors are: pre-investment alignment, strategic hurdles and personal motives faced by the entrepreneur, the reputation and connectedness of the venture capitalist, and the probability for entrepreneurial recycling.

Paper four explores the role of financial advisors in trade sale exits, by looking closer at why advisors are utilized, as well as by examining the factors determining the choice of a specific advisor. It is found that advisors are considered especially useful in bargaining situations, through playing the role of bad cops, and also by letting venture capitalists and entrepreneurs focus on their primary tasks. With regards to selection criteria, venture capitalists emphasize industry experience, prior relations and the size of the advisory firm. Finally, the findings are integrated in a framework explaining the role of financial advisors in venture capital trade sale exits.

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1. Introduction

Venture capital firms (VCFs) provide much needed risk-capital to entrepreneurial ventures. These ventures typically do not pay dividends, and the returns generated by the investments are instead harvested via an exit event, indicating that a profitable exit lies at the heart of venture capital.

Trade sales by far dominate as the most common exit vehicle. However, this dominance is not reflected in the academic literature on venture capital, where the issue of trade sale exits is a black box. The authors of this thesis seek to take the first steps towards opening that black box, by exploring the issue of venture capital trade sale exits. The thesis is paper-based, with the main academic contributions belonging to the four papers appended to this document.

To offer the reader sufficient context within which to place the papers, this document opens by giving a general introduction to the phenomenon of venture capital. Thereafter we move on to argue the importance of trade sale exits by highlighting relevant statistics. The following section gives some overall reflections on the methodologies utilized in this research project. Next, the aim and main findings of each paper are presented in summarized form. Finally, we conclude and offer some overall implications of the thesis.

As stated, the reader's emphasis should be on the four papers appended. Paper one gives a thorough review of previous research on venture capital exits. Paper two through four are based on a multiple-case study of 19 completed trade sale exit processes performed by Norwegian and U.S. venture capitalists (VCs). These papers each focus on a specific theme. Paper two examines the link between pre-planned exit strategies and value-adding efforts. Paper three looks closer at the VC-entrepreneur (VC-E) relationship during trade sale exit processes. Finally, paper four explores the role of financial advisors in venture capital trade sale exits.

2. An Introduction to Venture Capital

Venture capital is a professionally managed capital pool that is invested in equity securities in private ventures. A venture capital fund can be classified into three categories, dependent on the institutions or individuals investing in it. An independent venture capital fund is limited, close-ended, and funded by third parties, while a captive fund is part of an organization, for instance a financial institution (Wright and Robbie, 1998). A public fund is funded by the government (Isaksson, 2006). In the following discussion we will emphasize the independent venture capital fund, as this is the most common type of fund (Sahlman, 1990) and the focus of this study.

The conventional legal form of an independent venture capital organization is the general partnership, where the VCs act as general partners of the VCF. The general partners make investment decisions and manage the firm's day-to-day operations. Typically, such firms are small and non-hierarchical, consisting of the general partners, associates and administrative personnel (De Clercq et al., 2006; Sahlman, 1990; Zider, 1998). A study by Gorman and Sahlman (1989) showed that the median VCF employed four general partners.

The general partners raise venture capital funds, attracting capital from both institutional and individual investors. These investors are referred to as limited partners, as they are not involved in the investment decisions. Typical limited partners include pension funds, insurance companies, and financial firms. The limited partners require an annual rate of return of between

25 % and 35 % on the capital invested. The venture capital funds have a defined lifetime, with typical life spans of seven to ten years before they are terminated. Some funds have an optional extension period, which is typically three years at a maximum. When the funds are terminated, all remaining capital and stocks are distributed to the investors (Cumming and Johan, 2008; De Clercq et al., 2006; Sahlman, 1990; Tyebjee and Bruno, 1984; Zider, 1998).

The amount of capital raised in each fund varies between firms, but is often at least US$ 100 million. Many VCFs also raise multiple funds over the life-time of the firm, often managing several funds simultaneously. The general partners manage the funds by investing in equity-based securities in several entrepreneurial ventures. The amount invested in each portfolio company typically varies from US$ 2 million to US$ 10 million (De Clercq et al., 2006; Zider, 1998).

The general partners are typically compensated in the following way: an annual managing fee of 1-3 % of the capital of each fund, and a success fee of 20 % of the profits, or 20 % of the returns over a predetermined level (De Clercq et al., 2006; Sahlman, 1990; Zider, 1998). Many general partners also invest some of their personal wealth in the funds established, often equal to 1 % of the total capital raised (Williams et al., 2006).

Typically, the general partners take an active role in monitoring the portfolio ventures, for instance through board positions and economic rights. The investments are developed over a time period of two to ten years before they are exited. Exits preferably take the form of an initial public offering (IPO) or a trade sale. The capital gains from the investments are immediately transferred to the limited partners upon exit (De Clercq et al., 2006; Gorman and Sahlman, 1989; Sahlman, 1990; Tyebjee and Bruno, 1984; Zider, 1998).

An illustration of the relation between the limited partners, the general partners and the portfolio companies in a venture capital fund is given in figure 1 (Zider, 1998).

Figure 1 - Relations between Actors in a Venture Capital Fund

As mentioned, the VCs raise capital from private investors, with the intention of investing in entrepreneurial ventures. Entrepreneurs with ideas approach VCs to attract funding. If successful, the VC invests in the entrepreneurial venture, and receives stock in return. The ownership share of the company is determined by the stage and the maturity of the entrepreneurial venture, but the VCs typically claim from 20 % to 60 % of the company (Zider, 1998). The VCs often invest several times in the same venture, a phenomenon known as staging of capital (Gompers, 1995; Sahlman, 1990). Eventually, the investment is exited, and the capital is transferred back to the private investors (Zider, 1998).

VCs invest in companies in different stages. De Clercq et al. (2006) distinguish between four stages of venture financing: seed, start-up, expansion, and buyout. The seed stage is characterized by an undeveloped technology and concept, and the entrepreneur seeks financing for research and development and business concept validation. In the start-up stage, the venture has a management team in place, a pilot of the product is created, and the product is ready for marketing. Funds will often be used for establishing marketing and sales activities. In the expansion phase, marketing activities are initiated and the venture is ready to grow. The venture is now seeking additional capital to finance this growth. The buyout stage venture is an established company where the capital is used for a leveraged buyout and a delisting if the venture is publicly traded (De Clercq et al., 2006). Such late-stage investments are typically not the domain of VCs. Instead, VCs typically invest in companies in the start-up and expansion stage (De Clercq et al., 2006). Such companies are associated with both high potential return and high risk (Sahlman, 1990).

The failure rate of companies in early stages is high, and estimates show that an entrepreneurial venture only has a 20 % chance of succeeding (Zider, 1998). In order to reduce the risk associated with their investments, VCs apply different mechanisms. They often co-invest with one or two other VCFs, a phenomenon known as syndication. One of the VCFs normally acts as the lead investor, being responsible for the due diligence, and with the main responsibility for the investment in the portfolio firm (Gorman and Sahlman, 1989; Lerner, 1994; Sahlman, 1990; Zider, 1998). Additionally, VCs employ contractual rights which give them a preferred position if the venture fails. Such rights may include convertible preferred shares and anti-dilution rights (Sahlman, 1990). Furthermore, most VCFs have a specific investment profile, and specialize in certain industries which they find especially promising (Zider, 1998).

To compensate for the risk inherent in entrepreneurial ventures, the VC demands a return in the order of ten times invested capital over a period of five years, which is equal to an annual rate of return of 60 % (De Clercq et al., 2006; Zider, 1998). Since a venture capital fund portfolio consists of some home runs (Dimov and Shepherd, 2005) and some failures, the realized return will vary considerably between the portfolio companies (Zider, 1998). Often, 50 % of the portfolio companies will return only the invested amount when realized. Therefore, the home runs need to generate ten to twenty times the invested amount to secure the required annual portfolio return of 25 % to 35 % (Zider, 1998).

2.1. The Venture Capital Investment Process

As the VCF successfully has raised a fund, focus shifts to the investment process. The activities performed by VCs during the investment process, from deal origination through investment decision, value adding, and finally exiting, have been under scrutiny since the groundbreaking article of Tyebjee and Bruno (1984). Since then, other scholars have modeled the venture capital investment activity (e.g. De Clercq et al., 2006; Fried and Hisrich, 1994). A comparison of three different models is given in figure 2. These contributions are selected due to their academic influence and practical relevance.

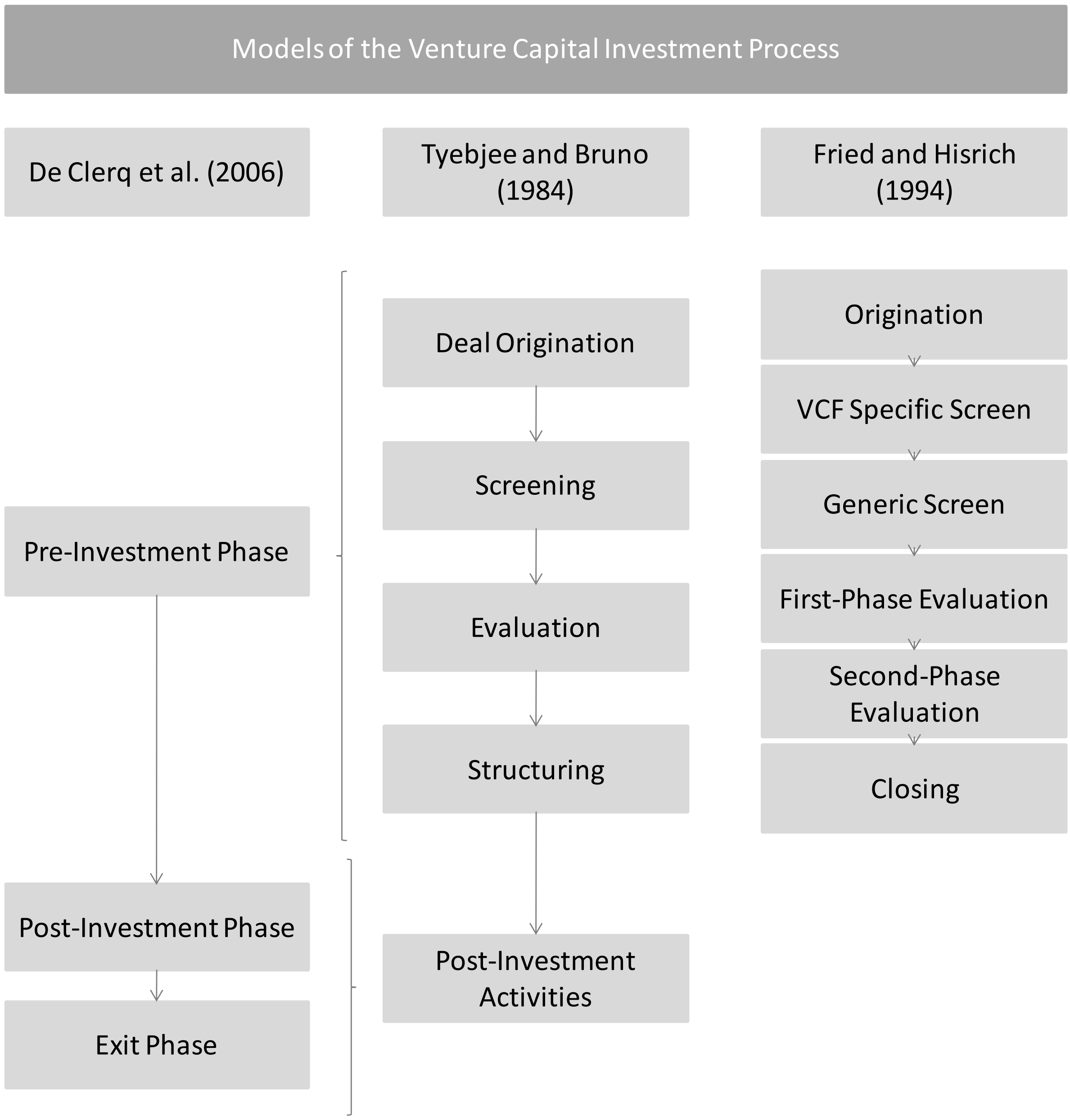

Figure 2 - Models of the Venture Capital Investment Process

In the following sections, these models will be presented using De Clercq et al.'s (2006) model as a framework. As seen from the figure above, this particular model distinguishes between three phases of activity for the general partners in a VCF when investing in a portfolio company: the pre-investment phase, the post-investment phase and the exit phase.

The Pre-Investment Phase

In the pre-investment phase, the VC wants to generate investment proposals from ventures that have the potential for large capital gains and evaluates these proposals with the purpose of picking winners. The VC looks for a unique business idea that offers a huge market potential, protection of intellectual property, and a realistic plan with respect to production, marketing and financial potential. Moreover, the idea must have the potential of being executed within the timeframe of the VC. Another important factor is the entrepreneur and management team. The team should be ambitious, motivated, honest, and experienced. Preferably, the management team has both general business experience and industry-related expertise (De Clercq et al., 2006).

Tyebjee and Bruno (1984) distinguish between four steps in the pre-investment phase: deal origination, screening, evaluation, and structuring of the deal. Deal origination is the process in which the VC becomes aware of investment opportunities. Deals come from three sources: cold calls, where entrepreneurs contact the VC when no prior relation exists; referrals, where investors or other intermediaries the VC has a previous relation with recommend the entrepreneur; and technology scans, where the VC actively seeks companies operating in a specific industry or technology-related area.

The largest amount by far of deal proposals originate without any active search by the VC. Several studies have shown that the most common behavior of VCs when seeking deals is to passively wait for potential deals to be presented to them (Fried and Hisrich, 1994; Sweeting, 1981; Tyebjee and Bruno, 1984). VCFs also often refer ideas to each other. This is particularly evident when a lead investor in an entrepreneurial venture seeks co-investors to establish a syndicate (De Clercq et al., 2006; Tyebjee and Bruno, 1984).

VCFs receive hundreds to thousands of investment proposals annually. Therefore, the VCs quickly assess the business opportunities in the screening step. Four criteria are used when screening business ideas: the investment size and the investment policy of the venture fund, the technology and market sector of the venture, the geographical location, and the financing stage. Many business opportunities get rejected in this phase (De Clercq et al., 2006; Tyebjee and Bruno, 1984).

The VC conducts a more detailed evaluation of the proposals that get through the initial screening. The evaluation includes a subjective assessment of criteria such as management commitment and skills, market size and growth, market position, and expected rate of return. While all of these criteria are important, several studies have shown that especially the quality of the management team is under scrutiny (De Clercq et al., 2006; Guild and Bachher, 1996; MacMillan et al., 1985). MacMillan et al. (1985) summarized this sentiment as follows:

> There is no question that irrespective of the horse (product), horse race (market), or odds (financial criteria), it is the jockey (entrepreneur) who fundamentally determines whether the venture capitalist will place a bet at all.

Therefore, it is no surprise that this stage of the evaluation usually includes a meeting between the VC and the entrepreneur, where the entrepreneur presents his plans (De Clercq et al., 2006; Tyebjee and Bruno, 1984).

If the result of the evaluation is positive, deal structuring follows. In this step, the entrepreneur and the VC negotiate the valuation of the business, the control granted to the VC and the covenants restricting the entrepreneur's actions. In the end, only a small fraction of the investment proposals end up being funded by the VC (De Clercq et al., 2006; Tyebjee and Bruno, 1984).

An even more refined classification of the pre-investment phase is offered by Fried and Hisrich (1994). These scholars distinguish between six steps in the pre-investment phase: origination, VCF specific screen, generic screen, first-phase evaluation, second-phase evaluation, and closing.

The origination step is similar to the deal origination step offered by Tyebjee and Bruno (1984). The VCF specific screen consists of criteria such as the size of the investment, the industry in which the venture operates, the venture's location, and the financing stage. This is equivalent to the screening stage of Tyebjee and Bruno (1984). The generic screen includes a review of the venture's business plan and other information about the investment which may be available to the VC.

In the first-phase evaluation, additional information is gathered and compared to the information given in the business plan. The VC contacts existing investors and customers, potential customers, and former business associates to access the information needed. Additionally, the VC and the entrepreneur meet at one or more occasions, where the purpose is to learn more about the business, evaluate the entrepreneur's knowledge of the industry, and get an overview of potential problems.

In the second-phase evaluation stage, the VC continues evaluation activities, but allocates considerably more time to the proposal. The focus is switched from determining interest in the deal to determining the risk factors of the investment, and how they can be mitigated. Due to the considerable time committed, the VC usually has an understanding of the terms and structure of the deal before entering this stage. In the closing, the details of the deal are negotiated and contracts are signed.

The Post-Investment Phase

In general, VCs are active investors, spending considerable time on their investments (Steier, 1998). Gorman and Sahlman (1989) found that most VCs spend more than half of their time actively involved with their portfolio companies. In the post-investment phase, the VC involves himself in two main activities: monitoring and value-adding (De Clercq et al., 2006). The purpose of these activities is to enact a positive influence on the value of the portfolio company.

The VC is often more involved than other investors in monitoring their investments. This is due to several reasons. For instance, investments in entrepreneurial ventures are illiquid, and cannot be sold immediately. Further, the uncertainty associated with entrepreneurial ventures is pronounced, and therefore the VC must spend time determining the current status and future prospects. Additionally, the VC is paid by the limited partners to monitor the investment, and the success of the portfolio company is in the VC's own interest. The VC is especially interested in whether or not the venture is able to reach predetermined milestones. In order to monitor the investments, the VC often acts as a director of the company, in addition to requiring the management team to submit regular updates of the company status (De Clercq et al., 2006).

The VC also conducts activities that add value to his investments. For instance, he may provide operating expertise, financial and strategic management, network, and experience in recruiting personnel (Ehrlich et al., 1994). Based on a case study by Pratch (2005), De Clercq et al. (2006) suggest that a VC can add value in six different ways, by undertaking:

- A strategic role: the VC can act as an advisor on important strategic, marketing, and organizational issues.
- A financing role: the VC can contribute with developing internal financial procedures, raising additional external capital, and contribute in the exit of the investment.

- A networking role: the VC has a network of contacts that can contribute with recruitment advice, raising additional capital, and mapping potential customers and exit possibilities.
- An interpersonal role: the VC can provide moral support when times are tough, and act as a discussion partner on sensitive issues.
- A reputational role: a successful VC can lend credibility to the entrepreneurial venture, and thereby help secure additional financing, generate sales, and recruit new members to the management team.
- A discipline role: the VC must evaluate the management, which may be disciplinary to the entrepreneur, and be beneficial for the venture as a whole.

A central question that is sought answered by the research on value-added is: Do VCs add value? Efforts made to answer this question have led to inconclusive answers (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).

What is for certain, however, is that VCs spend a considerable amount of their time actively involved with their portfolio companies; an activity that would make no sense should the VC himself doubt that he can add value to the entrepreneurial ventures. Therefore, while scholars thus far have been unable to give a definitive answer to the question of whether or not VCs add value to their portfolio companies, the conclusion can be drawn that the practitioners themselves believe that they can, and spend a considerable amount of their time on activities intended to do just that.

The Exit Phase

In the exit phase, the VCs divest their holdings in their portfolio companies (De Clercq et al., 2006). In their general theory of venture capital exits, MacIntosh and Cumming (2003) provide a theoretical starting point for understanding exits:

> … a VC will exit from an investment when the projected marginal value added (PMVA) resulting from its stewardship efforts, at any given point in time, is less than the projected marginal costs (PMC) of these efforts.

While this theory is based on a multitude of what the authors admit are unrealistic assumptions (for instance that the fund has an infinite lifespan, that the portfolio company at any given point in time can be exited at a price which best represents the true value of the firm, and that the VC freely can redeploy capital harvested from one investment into other investments), the basic rationale of comparing marginal costs with marginal value added holds considerable truth.

Cumming and MacIntosh (2003) present five principle exit vehicles, and distinguish between full and partial exits. The five principle exit vehicles, listed in order of the typically assumed preference for the VC, are: IPO, acquisition, secondary sale, buyback, and write-off. A full exit occurs when the VC divests all of his holdings at the time of the sale, while a partial exit indicates that the VC keeps a share of his original holdings when the exit occurs.

An IPO is the first sale of shares in a portfolio company to the public. Often the VC retains most of his shares after the offering date, and divests in the following period, due to lock-up agreements and legal regulations. Therefore, a full IPO exit is defined as the situation where the VC divests all of his holdings within a year after the offering date. A partial IPO exit occurs when the VC holds some of his shares after this date. This distinction is by convention and by recording policies of North-American industry organizations (Cumming and MacIntosh, 2003). An IPO often gives a high valuation, and is assumed to be favored by management, who retain their positions. However, an IPO is associated with the previously mentioned lock-up agreements for the VC, meaning that he carries risk by retaining his shares. Illiquid public markets may also make it difficult to sell the shares (Wall and Smith, 1997).

An acquisition is defined as a sale of the entire portfolio company to a third party. This exit vehicle is also commonly referred to as a trade sale, and we will use trade sale to denote this exit vehicle throughout this thesis. There are two different types of trade sale exits; the financial exit, where the value of the entity being sold is assigned based on its future profit generating power; and the strategic exit, where the buyer assigns value to the entity being bought based on what future profit can be generated by the buyer by exploiting the assets and capabilities of the target (McKaskill, 2009). A full trade sale exit means that the VC receives cash for the portfolio company, while a partial exit means that the VC receives shares in the acquiring company as part of the compensation (Cumming and MacIntosh, 2003). A trade sale involves lower fees than an IPO, and often offers a full exit. However, there may be few buyers in some countries, and the management team is often assumed to be negative to such an exit (Wall and Smith, 1997).

A secondary sale is the sale of the VC's shares to a strategic acquirer or another VCF. The difference between a trade sale and a secondary sale is that in the case of a secondary sale it is only the VC's shares that are sold. A full secondary sale involves the sale of all of the VC's shares. A partial secondary sale involves the sale of parts of the VC's holdings (Cumming and MacIntosh, 2003).

A buyback occurs when the entrepreneur or the portfolio company buys the VC's shares. A partial buyback exit is defined as a sale of a part of the VC's holdings, while a full buyback exit occurs when the VC sells all of his shares in the portfolio company (Cumming and MacIntosh, 2003).

A write-off is conducted when the entrepreneurial firm has failed or when it is barely profitable. A full write-off means that the VC walks away from the investment. This is often followed by the bankruptcy of the portfolio firm. A partial write-off is a write-down of the value of the assets in the company. A venture that is partially written off can be viable and barely profitable, but lacks the necessary potential to justify that the VC should devote more time and effort to it. Such a venture is also denoted as a "living dead" company (Cumming and MacIntosh, 2003).

3. Motivation for Study

As seen, the VCs' portfolio companies are typically cash-constrained growth ventures that do not pay dividends in the investment period. Instead, returns are gathered as capital gains when divesting the venture (Cumming et al., 2006). It is capital gains that determine the success of venture capital funds – and ultimately the success and survival of the VC and the VCF. A profitable exit from the investment therefore lies at the heart of venture capital (Cumming and MacIntosh, 2003).

However, successful exits are hard to achieve. Already in the mid-nineties, a study conducted on behalf of the European Venture Capital Association (EVCA) found that over 70 % of the VCs struggled with problems when divesting their investments (Wall and Smith, 1997). When comparing the level of new investments with the number of exits, the study showed an exit overhang, indicating that VCs did not exit their portfolio companies within the desired time frame (Wall and Smith, 1997).

These problems are unfortunately still evident today (Hege et al., 2009; Oehler et al., 2007). The last decade has shown a decrease in returns experienced by VCs, and in the U.S. the quarterly returns have fallen from over 80 % around year 2000, to single digit and even negative percentages in the recent years (Ghalbouni and Rouizes, 2010).

The decreasing returns correspond with a steep fall in the number of exits completed since the turn of the millennia and a longer time from investment to exit (Ghalbouni and Rouizes, 2010). Figure 3 shows the development of the number of exits from 2002 to 2010 in the U.S., based on data from the National Venture Capital Association (NVCA, 2011). The figure shows that exits are highly dependent on market conditions, as seen by the lower number of exits in the aftermath after the dotcom bubble in 2001 and the financial crisis of 2007-2008.

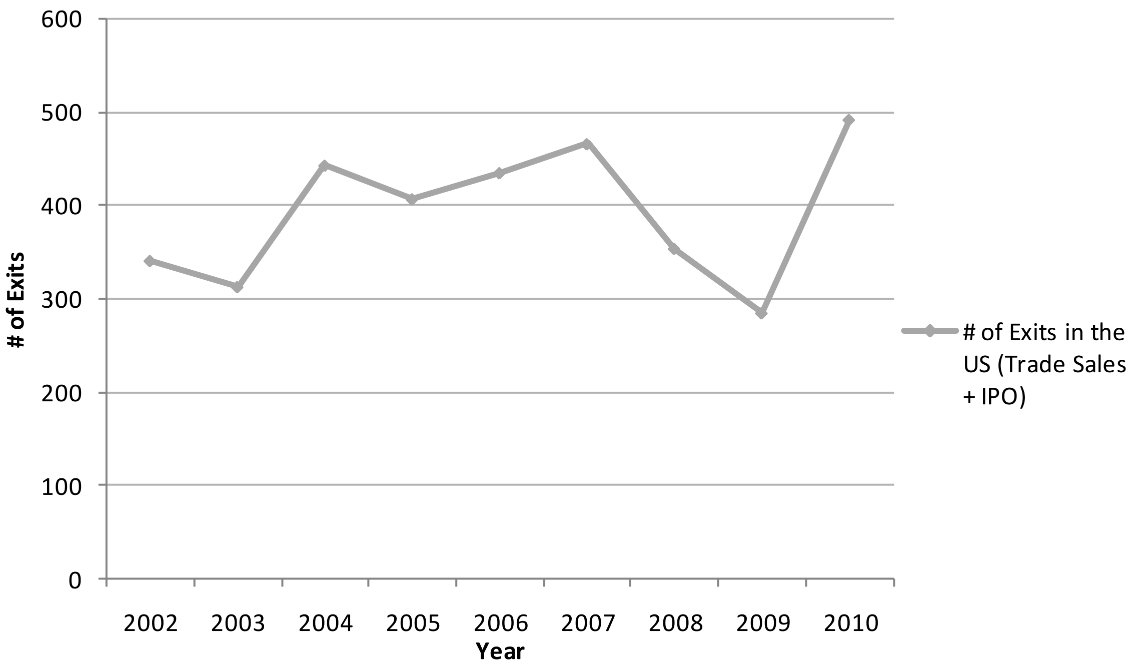

Figure 3 - The Number of Exits of U.S. Venture Capital-Backed Companies, 2002-2010

The importance of exits for venture capital has led some scholars to explore the theme academically. The current research on venture capital exits is to a large degree focused on IPOs (Félix et al., 2008; Isaksson, 2000). This focus on IPOs can be explained by two factors. First, IPOs are often classified as the most prestigious exit vehicle due to the publicity obtained and the soaring returns created by some offerings (Chaplinsky and Gupta-Mukherjee, 2010; Dimov and Shepherd, 2005; Megginson, 2004). Second, the availability of data for IPOs is much better than for other exit vehicles.

As the number of IPOs was much higher in the eighties and nineties than in the last decade, both in absolute number and compared to other exit vehicles, the focus on IPOs in the academic research seemed logical. Today, however, the focus on IPOs is not in line with the empirical world of exits. In fact, statistics show that the trade sale is by far the most common exit vehicle. Figure 4, also deduced from the NVCA (2011), shows the number of completed trade sales and IPOs in the U.S. in the period from 2002 to 2010.

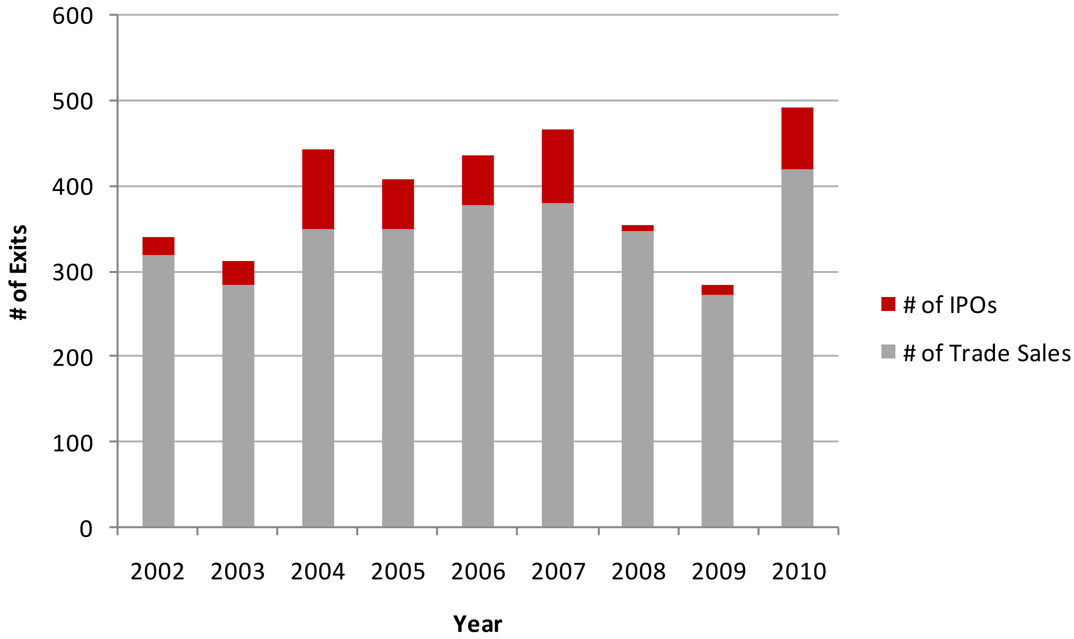

Figure 4 - The Number of Trade Sale and IPO exits in the U.S., 2002-2010

Two patterns appear from this figure. First, trade sales are a much larger exit vehicle than IPOs measured by the number of transactions completed. Second, both exit vehicles are subject to market conditions, but the consequences of an economic downturn is relatively more evident for IPOs. In 2008 and 2009, after the last financial crisis, the IPO exit window was basically closed, with just 18 IPOs in these two years combined. For trade sales, the exit window was still open, as shown by the 621 transactions that were consummated in the same period. Statistics from the EVCA and the Danish state investment fund Vækstfonden show the same pattern in Europe and the Nordics (EVCA, 2010; Vækstfonden, 2009).

As mentioned, IPOs are believed to give better returns than other exit vehicles, leading some scholars to characterize IPOs as the home run exit vehicle (Dimov and Shepherd, 2005). But, as seen by figure 5 below, this has not been the case in the U.S. for the last decade. This figure shows the average deal value and offering amount (in USD millions) for trade sales and IPOs respectively in the U.S. between 2002 and 2010, based on numbers from the NVCA (2011). For the last six years, the average trade sale value has been larger than the average IPO offering. It has to be taken into account, however, that the average value of the trade sale transactions are based on the deals where the exit value has been disclosed. In a significant number of trade sale transactions, the deal value is not disclosed, suggesting that these numbers must be treated with caution.

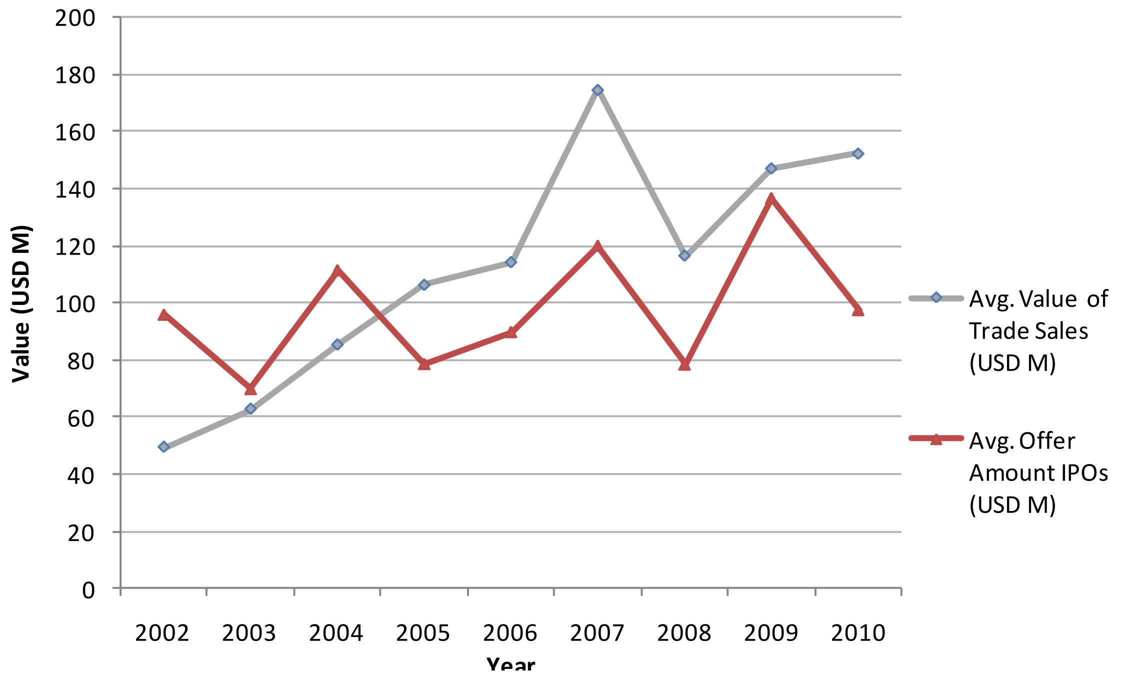

Figure 5 - The Average Deal Value of Trade Sale and IPO Exits in the U.S., 2002-2010

Taken together, these statistics show an interesting pattern. Despite the importance of exits to VCs, they struggle with exiting successfully. Moreover, trade sales are more common relative to IPOs, and also found to be more profitable. Trade sales are therefore instrumental for the venture capital business model in order to deliver the required rate of return. However, as popular and significant as ever, the importance of trade sales is not reflected in the academic research on venture capital exits. It is the possibility for opening this black box that is the main motivation behind the focus of this master's thesis.

4. Methodology

This section covers some reflections on the overall research process of this thesis. For a more academic discussion regarding research design and methods, we direct the attention of the reader to the method chapter included in each paper.

The Point of Departure

The basis for this master's thesis was laid during the fall of 2010, when the authors were working on their project thesis: "The Venture Capital Exit Process". The project thesis included a thorough literature review. This review first looked closer at general venture capital research, in order to give the authors a strong grounding in the field of venture capital. Thereafter, articles relevant for the venture capital exit process were reviewed. In total, 42 articles were selected for this second part of the review.

Based on this review, it became apparent that the issue of venture capital exits had not received sufficient attention from scholars. While there were some studies drawing attention to various factors with regards to exits, few looked closer at the issue from a holistic point of view. Paper one included in this master's thesis summarizes the findings of the review, and was written during the spring of 2011. The main contribution of this paper is the development of an overarching model of the venture capital exit process, denoted “The Road to Venture Capital Exit”.

As discussed in the previous section, however, the most striking finding was that there was basically no research-based knowledge on the topic of venture capital trade sale exits. With the discussed importance of trade sale exits for the venture capital business model in mind, this issue intrigued us. Close to nothing was done on the topic from an academic point of view, yet it was ripe with potential problems, and of an instrumental practical importance. Simultaneously, practitioners we discussed the subject with indicated great interest in the results of a research project focused on this area.

With very little done on the subject so far, it was quickly decided to make this an exploratory, multiple-case study. We aimed at enhancing the understanding of the phenomenon of venture capital trade sale exits, and thereby provide insights into a complex process. In order to do that, we did not want to enter the research process with pre-conceived assumptions of what the interesting questions to ask were. Instead, the data collected was determining for what was finally examined in the three papers built on the case study, thus making this an inductive study.

Sampling

Detailed information about trade sale exit processes is regarded as sensitive both on a business and personal level. The access to informants was therefore a potential problem. Based on strategic sampling of completed trade sale exits in various industries and geographies, several interesting cases were identified. We initiated contact with potential informants either directly or via individuals in our personal networks. As we immersed ourselves in the venture capital-entrepreneur community, we were also introduced to several cases by actors lending a helping hand.

Based on these efforts we included in total 19 trade sale exit processes in our sample. Seven of these cases were trade sale exits performed by U.S. VCs, while the remaining twelve were performed by Norwegian VCs. The cases included span over ten different industries. An overview of the cases included in the study is given in the table below.

Table 1 - Overview of Cases

Case	Industry	Acquired	Informants
Avalanche	Cable	2006	VC
Blackhawk	Sensors	1998	CEO
Bruin	Electronics	2006	VC, CEO
Canuck	Networking hardware	2005	VC
Coyote	Electronics	2007	2 VCs, CEO
Flame	Networking hardware	1996	VC
Flyer	Software	2007	2 VCs
Hurricane	Energy	2007	VC
Islander	Oil service	2007	CEO
Lightning	Software	2010	VC
Oiler	Wireless	2006	CEO
Panther	Energy	2007	VC
Penguin	Software	2009	CEO
Ranger	Oil service	2008	VC
Sabre	Networking hardware	1999	VC
Senator	Electronics	2011	VC
Shark	Telecom	2010	VC
Star	Telecom	2006	VC
Thrasher	Healthcare	2011	VC

Interviews

During the spring of 2011 we conducted in total 21 interviews. 15 of the interviews were with VCs, five of the interviews were with entrepreneurs, and a final interview included both the entrepreneur and the VC. In total, these interviews lasted 15 hours and five minutes. All interview sessions were tape-recorded and transcribed verbatim. These transcriptions totaled 197 single-spaced pages, and nearly 145 000 words.

Interview guides were built in order to ensure sufficient consistency between interviews. Separate guides were created for the VC and the entrepreneur interviews, in order to ensure that we covered specific areas relevant for each type of informant. These interview guides can be found in the appendix. Initial drafts of the guides were written by the authors based on knowledge gathered from the literature review. Thereafter, academics and practitioners with significant experience within the field were asked to comment on them and offer suggestions for improvements. Thus, by the time the interview guides were put to actual use, they had already been updated and refined several times. Nevertheless, we made minor adjustments to the guides as we recognized areas in need of improvement during the interview process.

The interviews were semi-structured. We as interviewers used the interview guide to make sure that we touched upon relevant areas, but to a large degree the respondents were allowed to speak freely. We strived to have two researchers present at all interviews. However, due to wide geographical distances with interviews taking place in major cities in Norway as well as in the U.S., this was not always possible to achieve.

The interviews with Norwegian respondents were conducted in Norwegian. Quotes included in the papers are translated into English by the authors. Every precaution was taken to ensure that nothing was lost in translation. In addition, respondents were given a citation check, which led to some minor adjustments in the quotes.

Data Analysis

The empirical data we had collected after the interviews were completed was incredibly rich, and, for us as researchers, extremely exciting. Based on the transcriptions and secondary data collected from among others press clippings, web sites and presentations, mini-cases were built for each of the trade sale exit processes included in the study. Thereafter, within-case and cross-case analysis of the data was performed. This was a highly iterative process, with the authors frequently stepping back and forth between the data and analysis.

From this inductive approach several areas emerged as especially interesting. Three areas were found to be important enough that papers were written; the link between pre-planned exit strategies and value-adding activities (paper two), the venture capitalist-entrepreneur relationship during trade sale exits (paper three), and the choice of financial advisors (paper four).

As paper two solely looked at the investor role, the cases where the entrepreneur was the informant were not included. Similarly, the Shark case was dropped, due to relevant factors not being covered in the data collected. The Shark case was also dropped from paper three for the same reason. Paper four included all cases.

Limitations

The selection of cases was based on a strategic sampling of completed trade sale exits. As such, our sample is not statistically representative, indicating that our findings are not generalizable. However, we strove to increase the generalizability of our findings by including cases from various industries and from different countries.

Since we were sampling completed trade sale exits, all of the processes included by definition belong to the past. Thus, retrospective bias is a potential problem. This is especially relevant for the oldest cases included. However, the interviews started with the respondents being asked to give a recount of the events leading to investment and further to the exit decision was made. Such open-ended questioning should improve the accuracy of our data.

Only two of our cases involve the venture capitalist-entrepreneur dyad, with both sides acting as informants. While we entered the study with the goal of attaining many such informant dyads, it proved difficult to gain access. Interviewing only one side of the dyad may obviously affect the data collected with informant bias and partial information. The data was triangulated with secondary sources in order to minimize this problem.

Due to the sensitivity of the data collected, the informants may have withheld information deemed too sensitive to share. In order to motivate the informants to share freely, all cases are given code names in order to ensure anonymity. In addition, all informants were given the chance to remove information from the papers that they deemed confidential. None of the informants utilized this option.

Overall, we are aware of the limitations of the data collected in this study, and we have taken steps in order to ensure that we treat the findings with the necessary caution. However, the informants and cases included fit the aim of this research study well. We believe that the data provided was as accurate and solid as could reasonably be expected with the time and resources of this study in mind.

5. Summary of Appended Papers

This section gives a brief overview of the aim and findings of the four papers that are appended at the end of this thesis.

5.1. Paper 1: The Venture Capital Exit Process

Aim of the Paper

The purpose of this paper is to take the first steps towards creating an overarching model of the venture capital exit process by examining the following research questions:

- Which variables influence the venture capital exit process?
- During which phase of the venture capital investment activity process do these variables have their highest influence?
- How do these variables influence the exit process?

Summary of Findings

Through a thorough literature review covering a broad range of disciplines, an overarching model denoted "The Road to Venture Capital Exit" has been developed, covering the entire investment cycle from pre-investment to the exit phase. To the authors' knowledge, this is the first overarching model of the venture capital exit process that has been developed, as existing literature tend to focus on subsets of the exit process. Six categories of variables were identified; Economic, Governance, Network, Strategic, VCF-specific and Venture-specific. The model takes into account the fact that some of these variables are exogenous, while others are open to manipulation by the VC. The model also acknowledges that some of these variables are of a dynamic nature.

5.2. Paper 2: Pre-Planned Exit Strategies and Value-Adding in Venture Capital Trade Sale Exits

Aim of the Paper

The aim of this paper is to examine:

- The different mindsets towards pre-planned exit strategies among VCs.
- If there is a link between having a pre-planned exit strategy and the focus of the VC's value-adding activities.

Summary of Findings

The findings indicate the existence of two polar groups of investors; the Tailor and the Architect. The Tailor is a close tracker with a clear focus on exits from day one. He uses exit possibilities as well as traditional business possibilities as criteria to evaluate his investments. He also adds value with exit specifically in mind, focusing his value-adding activities on the areas that will maximize the probability for success of the pre-planned exit strategy. The Architect does not use exit possibilities as an evaluation criterion. He does not add value with exit specifically in mind, but will have a more general focus in his value-adding, and believes that the best exit strategy is to build a strong company.

5.3. Paper 3: The Venture Capitalist-Entrepreneur Relationship during Trade Sale Exits

Aim of the Paper

The purpose of this paper is to shed light on the VC-E relationship during trade sale exit processes. Specifically, the following two research questions are investigated:

- What characterizes the VC-E relationship during trade sale exit processes?
- Which, if any, factors influence the cooperative level of the VC-E relationship during a trade sale exit process?

Summary of Findings

We find that the VC-E relationship during trade sale exit processes is characterized more by consensus and cooperation than by conflict and defection. In none of the cases covered was the exit decision put to a formal vote in the board, nor did the VC in any of the cases utilize special legal rights to force the entrepreneur to accept the exit decision. While some sort of agreement could be expected due to our sample, the low level of conflict seems to nuance the often stated assumption that entrepreneurs will oppose trade sale exits. Further, we find that several factors influence the degree of cooperation in the VC-E relationship during the trade sale exit process. These factors include the pre-investment alignment with regards to the exit, the strategic hurdles and personal motives faced by the entrepreneur, the reputation and network connectedness of the VC, and the probability for entrepreneurial recycling.

5.4. Paper 4: The Choice of Financial Advisors in Venture Capital Trade Sale Exits

Aim of the Paper

The purpose of this paper is to explore the choice of financial advisors in venture capital trade sale exits. More specifically, the following two research questions are investigated:

- Why do venture capital-backed companies engage financial advisors in trade sales?
- What factors influence the choice of a specific financial advisor?

Summary of Findings

We find that venture capital-backed companies in trade sale exits emphasize many of the same factors as suggested by the general literature on financial advisors. However, the data suggests some extensions. With respect to the first research question, we find that VCs believe that advisors are especially useful in a bargaining situation, where they for instance can take the role of bad cops, and by letting VCs and entrepreneurs focus on their main tasks. Regarding the second question, industry experience and prior relations are the most frequently mentioned determinants. Further, the size of the advisory firm is put forward as an important factor, suggesting that VCs are conscious of receiving top attention from their advisors. Finally, we integrate these findings in a framework that explains the role of financial advisors in venture capital trade sale exits.

6. Conclusions and Implications

Trade sales by far dominate as the most common, profitable exit vehicle for VCs. Successful trade sale exits are therefore of high importance for VCs and entrepreneurs alike. However, this importance is not reflected in the literature, with close to no studies looking closer at venture capital trade sale exits. Therefore, this master's thesis sought to explore the phenomenon.

Paper one gives a thorough review of relevant literature. Based on this review, an overarching model of the venture capital exit process denoted "The Road to Venture Capital Exit" was developed.

Empirical data was gathered via a multiple-case study, involving 19 completed venture capital trade sale exits. Twelve of the exits were performed by Norwegian VCs, while the remaining seven were performed by American VCs. The case companies included span over ten different industries, and were acquired between 1996 and 2011.

From this rich, empirical data an inductive approach led to three different papers, all focusing on different aspects of the venture capital trade sale exit process. Paper two explores the existence of two different investor archetypes, and the link between pre-planned exit strategies and value-adding activities. Paper three sheds light on the VC-E relationship during the trade sale exit process. Finally, paper four explores the choice of financial intermediaries in the execution of the trade sale process.

Thus, this thesis has taken significant steps towards opening the black box of venture capital trade sale exits. Our genuine hope is that these contributions will inspire other scholars to continue investigating the phenomenon. Research-based knowledge can help practitioners improve their performance, with virtuous effects for VCs, entrepreneurs and society at large.

6.1. Implications for Practitioners

We have been deeply emerged in the venture capital community over the past six months. This has given us the opportunity to see the trade sale exit process from both the entrepreneur and the investor side, as well as to compare different practices among different VCFs. Through the process, we have seen single cases where what seems to have been best practice in several aspects of the trade sale exit process has been identified. As we have evaluated a large number of cases, we are left with several areas where we feel that we can provide helpful advice to practitioners. We are humbly aware that none of us have any experience from the venture capital industry. Nevertheless, we feel that we might be able to provide some advice from an outsider's perspective. This section will therefore present our recommendations for practitioners.

Make sure all parties are aligned – at all times. Although this might seem like an obvious statement, we have seen cases where there is more of an implicit alignment towards the end goal; the exit. Some VCs assume that the founders are willing to give up control of the company in an eventual trade sale, without having a discussion pre-investment. This is also partly an advice to the entrepreneurs; if they want their company to stay in the family for generations, venture capital is perhaps not the right financing choice. If the different parties have an open discussion about their plans and aspirations pre-investment, future conflicts can easily be avoided.

But alignment is not crucial only in the pre-investment phase, it is also important to make sure the parties are aligned throughout the entire investment cycle. Although VCs have the possibility to force a sale through drag-along rights, it is rarely done in trade sale exits. One of the main reasons is that an acquirer is not only buying a company, he is also buying the human capital inherent in that company. A management team who does not agree with an acquisition process might destroy significant deal value through their reluctant attitude towards the potential buyer. This might in turn have significant consequences for the post-acquisition performance. Since we have seen that the management is more likely to have a positive inclination towards a trade sale when they are facing significant strategic hurdles, we recommend the VC to try to time a trade sale exit with these hurdles. This will probably benefit the VCs reputation in the long run, which brings us to the next recommendation.

Life is a multi-round game. This is especially true in the venture capital community, since VCs often are specialized within industry and by geography. VCs are dependent on getting a steady deal flow, and if they get a reputation for not listening to entrepreneurs, that deal flow will diminish. Again, alignment through the entire process is the key. Also, since venture capital investments are syndicated in most cases, a VCF with a bad reputation will have a hard time getting other VCFs to join a syndicate, since they will avoid affiliation with the industry's bad guys. Finally, we often see that the same companies make several acquisitions within the same space, and that often means that the VC will have to deal with them on a repeated basis. A reputation for selling bad companies will hence naturally decrease the scope of potential buyers.

An action that can be taken to reduce potential reputational damage is to hire intermediaries to assist in the acquisition process. By having a third party involved to play the part of bad cop, the other actors get someone neutral to blame for their grievances. But being the bad cop is not the only area where intermediaries can add value, as shown in our next advice.

Know what your intermediary can do for you. As mentioned earlier, most VCFs are specialized within a few industries. This means that they have an intimate knowledge of the space they operate in, and that they most likely will be aware of the potential acquirers of their portfolio company. This is sometimes used as an argument against using advisors. We believe that an intermediary can add value in identifying potential buyers in some cases, but this is not where their main contribution is. The focus of the intermediary should rather be on the practical issues of an acquisition process, be it an auction or a negotiated sale. The VCs are time constrained, and are not expected to spend time on activities as creating information memorandums or facilitating an auction process. The same goes for management; they are in most cases better off focusing on day-to-day operations than deeply involving themselves in the nitty-gritty details of a sales process. The intermediary should be used to unburden both the VC and the management, so they can be able to focus on their main tasks.

If the pre-planned exit strategy is trade sale, act accordingly. We have seen a few cases where there has been a clear goal of a trade sale exit from day one, but where the VCs still had a general focus in their value-adding. Our advice is to always remember the end goal, and take measures to increase the probability of a successful exit. And since this business is all about finding the right buyer, the right buyer needs to be aware that the portfolio company will be up for sale in the future. We believe that a good way to do this is through the use of strategic partnerships. By involving potential buyers, be it as sales partners, members of an advisory board, or other partnerships, it is easier to convey the value of a portfolio company and to create buzz around it. This is an arena where the VCs network acquired through the multi-round game of venture capital investing can be extremely valuable, and this potential value should be exploited. The earlier potential buyers are aware of the portfolio company, the easier it will be to actually get it acquired down the line.

Entrepreneurs: Know the consequences. Although most entrepreneurs are well educated in the ways of venture capital and know that an exit is unavoidable, we feel that this point cannot be accentuated enough. Entrepreneurs have to be aware that an exit will come, and take measures to ensure that the exit will be a pleasant event for all parties. Again, it all comes down to alignment. We would also argue that those entrepreneurs that picture themselves as serial entrepreneurs should remember our advice that life is a multi-round game. Although they might have to swallow a bitter pill in one specific exit, avoiding a high conflict level might be beneficial when they come looking for investment in the next round.

6.2. Implications for Further Research

This section highlights some general implications for further research of the master's thesis as a whole. For paper-specific implications, we direct the attention of the reader to the conclusions and implications chapter of each paper.

The literature review given in paper one first and foremost identified that the issue of venture capital exit processes is an area still ripe for exploration. While the IPO exit vehicle has received some attention, trade sales are still a black box. While we have taken the first steps towards opening that box in this thesis, many areas still remain. For instance, why is it that trade sales are associated with less prestige than an IPO? Successful trade sales require significant skill on behalf of both investor and management team, and may be even more profitable than an IPO exit. At the same time, trade sales are more likely to be a full exit, while IPO exits might require the VC to hold on to shares for a significant amount of time. How does this influence the VC's goal of IPO versus trade sale?

It is not only the trade sale exit vehicle that lacks coverage in the academic literature, however. Secondary sales, where the VC sells his holdings, typically to another financial investor, are gaining ground in Europe. In fact, according to the EVCA (2010), in 2009 secondary sales made up a significant share of venture capital exits in Europe, second only to that of trade sales (write-offs excluded). As the literature review demonstrates, this exit vehicle has received close to no attention in academia. With its growing importance, however, scholars should look closer at secondary sales. Among others, it would be highly interesting to investigate which type of portfolio companies are likely to be exited via secondary sales, how the management team reacts to this type of exit, and whether or not secondary sales are successful exits by venture capital standards.

The empirical data gathered in this study was based on a strategic sampling of completed trade sale exit processes performed in Norway and the U.S. Based on this data, in combination with a relevant theoretical backdrop for each paper's focus area, we have put forward several important propositions. Further research should investigate whether or not our propositions will survive empirical testing over a statistically representative sample. Thus, the next logical steps are to operationalize the propositions put forward into testable hypotheses, and subject them to the rigor of quantitative research strategies.

Further, the empirical data collected for this research project was based on trade sale processes that were successfully completed. While this was the correct path to take in this study, it would be very interesting to look closer at trade sale processes that failed in order to try to pinpoint which factors led to the failure of the exit. Such knowledge could prove instrumental in improving the overall return generated by the venture capital industry.

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Appendices

Appendix 1 – Interview Guide VC

Background information about interviewee

- Name, position, experience, relevance for case

The investment

- Background information about the company
- Context (market outlook)
- Terms (equity share, amount, syndication)
- Preplanned exit strategy? Exit strategy included in BP from entrepreneur?
- Execution of this strategy?
- Syndication
    - Was the deal syndicated?
    - When did the syndication take place?
    - Why syndication?
    - Value added from syndicated investors?
- Founder CEO/Hired Gun?

What kind of activities towards exit was conducted after the investment? (Auditors, IP, due dill. preparations, networking, positioning, 5P's, changes in management team)

Entrepreneur on board with regards to the need to exit?

Did the exit strategy change over the life of the investment?

Exit decision

- When was this decision taken?
- On what terms?
- Why? Part of the plan?
- Relationship VC/Entrepreneur
    - Involvement from entrepreneur in exit decision/process?
    - Different preferences (exit vehicle, timing, acquirer)
- Reputation
    - Importance of "home run" (IPO)?
    - Return (greed)?
- Timing
    - Market conditions
    - Termination of fund
    - Establishment of next fund

Exit process

- Marketing of company
    - Use of IP
    - Product brochures
    - Specific or broad marketing?
        - Geography, industry
    - Execution of marketing (management presentations, site visits, VC involvement)
    - Reputation of VC
- Choice of intermediary
    - Why/Why not?
    - Criteria for choice
        - Industry experience

        - Previous experience with intermediary (VC or portfolio company)?
        - References/network
        - Syndication
        - Price
        - Geographical coverage
        - Size of transaction versus size of intermediary
    - Broad or narrow search?
    - Fee structure
        - Incentives for intermediaries?
- Choice of acquirer
    - How did you identify potential buyers?
        - Syndication
        - VC network
        - Intermediary
        - Entrepreneur's network
    - How many potential buyers did you initiate negotiations with?
    - Strategic fit
    - Terms
        - Valuation
        - Structure of deal (Full or partial exit?)
    - Entrepreneur/VC involvement in choice
- Negotiations
    - Lead negotiator (experience with negotiations)
    - Use of intermediaries
    - Facilitation of process
        - Handling of information asymmetry (Dataroom?)
        - How much information is shared with prospective buyers
        - Some kind of information that you did not share
        - Continued/retained ownership
- Valuation
        - Differences between entrepreneur and VC in valuation?
        - Differences between company and acquirer(s) in valuation?
- Enforcement (use of contract)
    - Why/why not necessary?
    - Action towards exit in contracts?
    - Convertible/preferred securities?
    - Veto/control rights?
- Focus on day-to-day operations

Post-sale

- Involvement after sale (ownership, board position, advisor)
- Evaluate the exit
    - What went right?
        - Compared to general exit strategy/philosophy for VC-company
    - What went wrong?
        - Compared to general exit strategy/philosophy for VC-company
    - What did you learn? Something that you would have done differently next time?
    - Evaluate the intermediaries
        - Important for outcome?
        - What did they do right?
        - What did they do wrong?
        - Worth their fee?
        - Would you choose one next time?

Appendix 2 – Interview Guide Entrepreneur

Background information about interviewee

- Name, position, experience, relevance for case
- Founder/Hired Gun?

The investment

- Background information about the company
- Context (market outlook)
- Terms (equity share, amount, syndication)
- Preplanned exit strategy? (BP/Negotiations)
- Rich or king?
- Syndication
  - Value added from syndicated investors?
  - What are your thoughts on having multiple VCs as investors?

Did you have exit in mind from the start of the investment? (realization of VC need to sell)

Did you conduct any activities with exit in mind when building your company? (Auditors, IP, due dill. preparations, networking, positioning, 5P's, management team)

Exit decision

- When was this decision taken?
- On what terms?
- Why? Part of the plan?
- Did you agree? (timing)
- Relationship VC/Entrepreneur
  - Involvement from entrepreneur in exit decision/process?
  - Different preferences (exit vehicle, timing, acquirer)
- Reputation
  - Importance of successful exit? Serial entrepreneur?

Exit process

- Marketing of company
  - Use of IP
  - Product brochures
  - Specific or broad marketing?
    - Geography, industry
  - Execution of marketing (management presentations, site visits, VC involvement)
  - Reputation of VC
- Choice of intermediary
  - Why/Why not?
    - Criteria for choice
    - Industry experience
    - Previous experience with intermediary (VC or portfolio company)?
    - References/network
    - Syndication
    - Price
    - Geographical coverage
    - Size of transaction versus size of intermediary
  - Broad or narrow search?
  - Fee structure
  - Incentives for intermediaries
  - Your thoughts?

- Choice of acquirer
  - How many potential buyers did you initiate negotiations with?
  - How did you identify potential buyers?
    - Syndication
    - VC network
    - Intermediary
    - Entrepreneur's network
  - Strategic fit
  - Terms
    - Valuation
    - Structure of deal (Full or partial exit?)
  - Entrepreneur/VC involvement in choice
- Negotiations
  - Lead negotiator (experience with negotiations)
  - Use of intermediaries
  - Facilitation of process
  - Involvement of entrepreneur
  - Valuation
    - Differences between entrepreneur and VC in valuation?
    - Differences between company and acquirer(s) in valuation?
- Enforcement (use of contract)
  - Why/why not necessary?
- (Handling of information asymmetry)
  - How much information is shared with prospective buyers
  - Some kind of information that you did not share
  - Continued/retained ownership
- Focus on day-to-day operations?

Post-sale

- Involvement after sale (ownership, board position, advisor, new company)
- Evaluate the exit
  - What went right?
  - What went wrong?
  - What did you learn? Something that you would have done differently next time?
  - How important was the intermediary?
    - What did they do right?
    - What did they do wrong?
    - Worth their fee?
    - Would you choose one next time?

Paper 1

The Venture Capital Exit Process – A Literature Review

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Abstract

Both European and American venture capitalists are struggling with achieving satisfactory exits, leading to poor industry performance. In addition, both entrepreneurs and the society at large have a vested interest in the success of venture capital, due to its vital role as a financing actor for entrepreneurial growth ventures creating new wealth. A better understanding of the success criteria of the exit process is therefore sought after. Findings from this literature review lead to the establishment of an initial model of the venture capital exit process, denoted "The Road to Venture Capital Exit". Important aspects revealed include that exits are influenced by variables determined in all phases of the venture capital investment process, and that the process is influenced by variables both outside the venture capitalist's control and within his control sphere.

Introduction

Venture capital is a professionally managed capital pool that is invested in equity securities in private ventures. Venture capital funds are closed-end, limiting the investment holding period for the venture capitalist (VC). VCs typically invest in early-stage, growth companies, indicating that portfolio companies rarely pay dividends during the investment period. Therefore, capital gains acquired from a profitable exit lies at the heart of venture capital(Cumming and MacIntosh, 2003).

Successful exits are, however, not easy to achieve. A major survey commissioned by the Exits Committee of the European Venture Capital Association (EVCA) concluded that "European VCs are better at investing than exiting" (Wall and Smith, 1997). As much as 70 % of the responding VCs indicated that they had experienced difficulties exiting from their investments for various reasons. A quick comparison of the level of new investments with the level of exits also showed a significant exit overhang – indicating that many portfolio companies that normally should have been exited, were still kept on book. While one would have hoped that these challenges had been resolved by now, these exit problems are still relevant today (Hege et al., 2009; Oehler et al., 2007).

But it is not only European VCs that experience trouble exiting. Recent research presented in the Harvard Business Review concludes that American VCs are experiencing similar problems (Ghalbouni and Rouizes, 2010). The article states that VCs are facing significant challenges in successfully exiting their investments, pointing to the fact that the number and value of IPO and trade sale exits have fallen steeply from the numbers achieved during the golden period around the turn of the millennia. An illustrative showcasing of the severity of the problems encountered is the fact that the number of IPOs in the U.S. has dwindled from 17 per week in the year 2000 to a total of 15 in 2008 and 2009 combined. Thus, even though a profitable exit lies at the heart of venture capital, VCs do not seem to have a full understanding of the success criteria of the process, asserting the need for more knowledge.

Due to the importance of exits, the phenomenon has attracted some scholarly interest. There are many articles that cover various aspects of venture capital exits. However, these articles often cover only subsets of the venture capital exit process, typically focusing on the time to exit, the exit form, or the influence of control variables on exit (Félix et al., 2008).

Further, the population of articles tends to be focused on IPOs (Félix et al., 2008; Isaksson, 2000). In fact, this literature review uncovered only one article specifically focused on trade sale exit strategies, and this article dates back to 1994 (Relander et al., 1994). This focus on IPOs can be explained by two major underlying reasons. First of all, VCs are often presumed to prefer IPO exits due to the reputational premium and high returns generated (Dimov and Shepherd, 2005). Secondly, data is more freely available for IPO exits than for trade sale exits, making IPO exits more suitable for empirical research. However, recent studies clearly show that the trade sale is the dominant exit vehicle of the two (Giot and Schwienbacher, 2007; Isaksson, 2007).

Thus, while these contributions undoubtedly have brought the research-based knowledge on the field of venture capital exits forward, there are still considerable gaps to be filled. Therefore, the purpose of this paper is to develop an overarching model of the exit process based on the following research questions:

- Which variables influence the venture capital exit process?
- During which phase of the venture capital investment activity process do these variables have their highest influence?
- How do these variables influence the exit process?

The goal is to generate a better understanding of the variables influencing the venture capital exit process, making it possible for the VC and the entrepreneur to pave the way for more successful exits. To answer these questions, this paper gives a thorough literature review on venture capital exit processes. Additionally, relevant literature on value-adding activities, social capital and mergers and acquisitions (M&A) will be presented. The breadth of the literature search is motivated by the lack of research in the field of venture capital exits.

The findings from this review lead to an overarching model of the venture capital exit process, with relevant variables identified. Important aspects revealed include that exits are influenced by variables determined in all phases of the venture capital investment process, and that the process is influenced by variables both outside and within the VC's control sphere. To the authors' knowledge, this is the first framework developed that takes a holistic approach to venture capital trade exits.

The rest of this article is organized as follows: section II presents the methodology used to review the literature, and offers a critique of this methodology. Section III presents the literature review, while section IV structures the theoretical findings and develops a conceptual model. Section V concludes, suggests future research, and presents implications of the findings.

Methodology

Search for Literature

The literature review started out with a broad approach. In order to gain a better understanding of the venture capital industry, core articles covering venture capital processes were selected and analyzed. After gaining a better understanding of the venture capital world, a search for articles more specific to the field of VCs and exit processes was conducted. However, due to the limited research on the topic of venture capital exits, the search for literature needed to remain broad. Our goal was to achieve the best possible overview of the entire exit process, and as such we were interested in articles covering several aspects of the venture capital investment process.

The search followed two different approaches. Google Scholar (GS) was utilized as the primary search engine, and as a starting point key words and key phrases identified in the core literature were used as search terms. In order to select relevant articles, a combination of two criteria was used to judge the quality of the search results. The first criterion was the number of citations given by GS, while the second criterion was the journal ranking, as measured by the Financial Times ranking from 2007 and the classification made by the French business school École Supérieure des Sciences Économiques et Commerciales (ESSEC) from 2009/2010. In addition to these main criteria, the quality was also assessed by looking at the currency given by year of publication, and a subjective evaluation of the relevance of the content. There was also a clear goal of combining qualitative with quantitative studies in order to achieve methodological convergence (Jick, 1979).

In addition to the online search, a snowball sampling approach was used. After reading the articles identified using GS, it became clear that many of these had been citing the same studies. These frequently cited studies provided a better understanding of the elementary principles in the literature. By using this approach, important studies that would not have been found using solely online search could be added to the literature list.

These two approaches were used simultaneously, resulting in a reinforcing cycle. The search terms could be updated and modified, and hence the online search could yield more results. This in turn lead to more relevant literature found from the snowball sampling.

To get a broader knowledge in the area of exits and to avoid becoming too focused on topicality (Bruce, 2001), articles from the domain of M&A were included, since there is a close link between trade sales and M&As. In addition, this choice was motivated by the lack of studies covering venture capital trade sale exits.

Grouping and Selection of Articles

In order to group the wide array of articles properly, an approach in the spirit of grounded theory (Strauss and Corbin, 1998) was used. Each article was assigned key words, the key words were grouped into concepts, and these concepts were finally grouped into six categories. After searching for and reading a large number of articles, no articles identifying new concepts or areas of interest were found, and it was concluded that a satisfactory level of theoretical saturation was reached. The categories created were: *Choice of Exit Vehicle*, *Time to Exit*, *Legality and Control*, *Adding Value*, *Social Capital*, and *Mergers and Acquisitions.* The review of the literature is presented following the same topical structure.

The literature selected (presented in Appendix 2-7) was analyzed in two steps. First, each category was analyzed on a stand-alone basis to understand the different aspects of exit facilitation. Secondly, the findings from each category were combined to create an initial model covering the main research questions.

Criticism of Methodology

Although the literature search started out with a focus on articles published in high ranking journals with a high citation number, these criteria were bypassed to a certain extent when populating the categories, and there are a few articles included in this review that are currently unpublished. This choice might have affected the quality of the overall population, since only a subjective evaluation from the authors was used as a selection criterion.

There are two main reasons for why this alternative selection approach was used. Number one, as previously stated, the research on venture capital exits has been rather limited (Isaksson, 2007). Number two, the venture capital industry has experienced tremendous change over the past decade, and a lot of the high ranking literature is published in connection with the golden age around the turn of the millennia. By including newer work, although unpublished, it has been possible to capture the evolvement in the research on venture capital in general and on venture capital exits in particular. This argument is also supported by Bruce (2001), who states that "… students working in relatively new research areas need to read even studies that are of peripheral interest …" The authors of the unpublished papers have been contacted in order to make sure that the version included in this paper is the most current.

After selecting the articles to be used in the section covering value-adding activities, it turned out that all of them came from the Journal of Business Venturing. This came as a result of the approach used to select articles, and was not a deliberate choice by the authors. However, it has to be noted that this might have lead to a journal bias, where the views of this specific publisher have been overrepresented in this specific section.

The same authors are often featured several times in the literature list. This overrepresentation might have lead to a researcher bias, where these authors have been given too much attention. However, research covering venture capital exits is as previously mentioned fairly limited, and hence the number of researchers in the area is also limited. It has been a goal to only feature repeated authors if they are considered among the most respected in their field, and if the extra articles add new value to the literature review.

Literature Review

The following section will elaborate on the main findings from the literature review, and is followed by a summary of our main findings. A summary of the literature covered can be found in Appendix 2-7.

Choice of Exit Vehicle

Introduction

The choice of exit vehicle is an instrumental variable in the VC exit process. When exiting their investments, VCs employ five principal exit vehicles: IPOs, trade sales, secondary sales, buybacks and write-offs. There is also a distinction between full and partial exits, where partial exits indicate that the VC holds on to an amount of his original holdings when the exit occurs, whereas in a full exit all of the VC's holdings is divested at the time of the exit event (Cumming and MacIntosh, 2003).

These five exit vehicles vary widely in terms of the return potential they offer, the prestige involved in the exit, and the strain on both the entrepreneur and the VC (e.g. Brau et al., 2003; Cumming and MacIntosh, 2003; Gompers, 1996; Isaksson, 2000). When examining the venture capital exit process and trying to build an understanding of what the VC does and why, it is therefore imperative to review the existing research on what determines the choice of exit vehicle.

Main Findings

The first obvious revelation when covering the academic literature on the choice of exit vehicle is that all exit vehicles are not created equal. It is common to rank the exit vehicles in order of preference, where one also makes a distinction between what is the preferred vehicle for the VC versus what the entrepreneur might desire (Bascha and Walz, 2001). The most common ranking in order of preference for the VC is given as: IPO, trade sale, secondary sale, buyback and write-off – with the IPO as the obvious home run exit (Dimov and Shepherd, 2005; Wall and Smith, 1997).

For some of the exit vehicles this ranking is rather straightforward; it is clear that for both the VC and the entrepreneur an IPO will be preferred to a write-off. In fact, most authors (and for that matter VCs!) seem to draw the conclusion that the exit vehicles secondary sale, buy-back and write-off all represent a certain degree of failure, with little to no return for the VC (e.g. Cumming and Johan, 2008; De Clercq et al., 2006; Wang and Sim, 2001). However, Wall and Smith (1997) point to the fact that European VCs are missing out on profitable exits due to the excessive focus on IPO over trade sale, and since secondary sales are not considered as a serious exit vehicle. Thus, the traditional preference ranking of exit vehicles might be flawed.

Nevertheless, as a result of the fact that the IPO and the trade sale typically are viewed as the desired exit paths, and since the possibility of exiting in either of these fashions does imply a successful venture, the choice between the two has been the focus of several articles (e.g. Brau et al., 2003; Giot and Schwienbacher, 2007; Hellmann, 2006; Yang et al., 2008). While most authors state that the IPO is the preferred exit vehicle for both entrepreneur and VC (e.g. Gompers, 1996; Isaksson, 2000; Wall and Smith, 1997; Wang and Sim, 2001), others disagree, pointing to the fact that a trade sale might actually result in a higher valuation (and thus pay-off to the VC) due to the synergy potential that a potential acquirer could benefit from (Schilit, 1991; Wright et al., 1990).

Looking closer at these two top-ranked exit vehicles then, no undisputed order of preference between the two can be made. Instead, many factors specific for the venture being exited is posited to influence which exit vehicle is employed. According to Brau et al. (2003) four main categories of factors affect the decision between an IPO and a trade sale: industry characteristics, the role of market timing, the demands for funds by private firms, and deal specific factors.

In their study, Brau et al. (2003) find that 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 all are positively related to the probability of an IPO. In contrast, 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 are all factors positively related to the probability of being acquired.

Further, Poulsen and Stegemoller (2008) state that ventures with a higher growth potential are more likely to go public. This is perhaps not surprising, as ventures with a low growth potential typically do not fit the return requirements of the public market. Schwienbacher (2008), on the other hand, points to the importance of the innovation degree of the product or service offered. A higher degree of innovation makes it harder for potential acquirers to create fit between their own organization and the target, and thus lowers the value for the acquirer. The result is that firms with a higher degree of innovation are more likely to go public via an IPO.

As denoted earlier, one can distinguish between full and partial exits. Partial exits might seem counterintuitive, as they reduce the potential payoff to the VC without reducing the costs of the VC as an active investor. Nevertheless, they are quite common. According to Cumming and MacIntosh (2003), who looked into the determinants affecting whether a full or a partial exit will be executed, the main determinant is the amount of information asymmetry between the VC and the purchaser(s) of the VC's shares.

In the event that there is private information about the venture and its potential for success that is difficult or impossible to make fully available to the interested parties, the VC might hold on to a certain stake in order to signal the quality of the venture. The logic is that the VC is willing to retain a stake only if the venture truly is a good investment, and as a result a signal of quality is sent to the market (Lin and Smith, 1997).

The choice of exit vehicle is also influenced by the geographic location of the venture capital firm (VCF) in question. Several studies have concluded that there exist significant differences in exit behavior dependent on which country the VCF is operating in – a result that is often attributed to the institutional and legal factors of the specific market (Isaksson, 2000; Schwienbacher, 2005; Wang and Sim, 2001).

As seen by the preceding paragraphs, the choice of exit vehicle is influenced by a multitude of variables. These variables include factors specific for the venture itself and the greater macroeconomic picture it operates within. However:

> Venture capitalists may have more experience in choosing the optimal method for going public and may be subject to fewer personal preferences for liquidity or control than are the sellers of non-VC-backed firms since they invest in and divest from many firms (Poulsen and Stegemoller, 2008).

At the same time "VCs play an active role in directing investees towards the exit since this provides a means to cash-out their gains to earn a return on their investments (Wang and Sim, 2001)." Further, many VCFs have a stated preferred exit vehicle (Isaksson, 2007). Therefore, the influence of the VC himself when choosing the exit vehicle for the investment cannot be disregarded.

This point is expanded upon by Wall and Smith (1997), who distinguish between two types of VCs with respect to exit behavior: the passive investor, who takes a minority stake in the company, has a long-term view of the investment, and has not planned a specific exit route; and the proactive investor, who plans exit from the investment date, is motivated by cash, and gives the management incentives.

Similarly, Relander et al. (1994) point to two different patterns of exit behavior for the VC, known as the path sketcher and the opportunist. A path sketcher VC has a proactive attitude towards exit problems from the very start, planning potential exit opportunities even before the investment is made, and working actively on developing potential exits during the entire post-investment phase. The opportunist, on the other hand, has such a belief in his own management skills and the potential of the investment target that a profitable exit opportunity will develop when the time is right.

In conclusion, the exit vehicle employed when divesting portfolio ventures seems to be heavily influenced by a multitude of factors both within and outside of the VC's control sphere.

Time to Exit

Introduction

According to financial and economic theory, the time to exit is one of the parameters determining the attractiveness of an investment (Douglas, 1992). A shorter time to exit will increase the present value and return of the investment and hence increase its attractiveness (Sahlman and Scherlis, 1988). VCs also typically set a harvest date for their investments (De Clercq et al., 2006; Zider, 1998), and they therefore need to be able to influence the time aspect of exiting.

A basic assumption is that a shorter time to exit leads to a larger return on investment. This, however, is not always the case. The VC will have to compare the opportunity cost of continued involvement with the potential increased returns from adding more value to the investment (Cumming and MacIntosh, 2003).

Even though timing evidently is an important factor in the exit process as a whole, "… rarely has the speed with which a company reaches its IPO been investigated" (Shepherd and Zacharakis, 2001). This is true not only for the IPO exits, however. IPOs are overrepresented in the literature dealing with exit timing, and little attention has been paid to other exit vehicles (Giot and Schwienbacher, 2007).

Nevertheless, the time to exit is a highly important variable in the venture capital exit process. Therefore, this part of the literature review focuses on articles covering exit timing, with the goal of identifying factors that affect a portfolio company's time to exit.

Main Findings

The first important finding is that the type of exit vehicle affects time to exit. IPOs are by some scholars regarded as the fastest exit route, adding an explanation as to why it is the preferred exit route of many VCs (Espenlaub et al., 2009). Giot and Schwienbacher (2007) support this by using a competing risks model, where it is shown that VC-backed firms in the U.S. experience an increased likelihood of exiting through an IPO until a plateau is reached, followed by declining IPO exit possibilities. Trade sales have a more monotonic hazard rate, making it a more universal exit route.

A company is rarely exited in full just because an IPO has taken place. VCs often keep a part of their shares, hence creating a partial exit (Cumming and MacIntosh, 2003). This means that the time to exit not only includes the time up to the IPO; the time it takes to actually divest also has to be taken into consideration. But if VCs only are concerned with returns, why do they not sell all their shares immediately? Several researchers have looked at this apparent paradox. The most obvious answer is, of course, legal factors. The VC is often obliged to hold on to a certain percentage of his shares, due to lock-up and contractual agreements.

However, another interesting factor many point to is VC reputation. VCs with established reputations do not want to sell shares if they perceive them to be overpriced (Lin and Smith, 1997), since this might ruin their reputation. This is also supported by Neus and Walz (2005), who see the venture capital investment process as a repeated game. If secondary investors buying shares in an IPO experience overpricing, their confidence in the VCs might be shaken when the next IPO comes around. Therefore, VCs might want to hold their shares until the true value of the company is revealed by the market, especially if there is a large potential for overpricing.

While more experienced VCs are concerned with not losing their reputation, younger VCs are trying to build one. For limited partners it might be hard to judge a VC's competence (Gompers, 1996), and an IPO might signal an ability to pick good investments, making it extremely important for inexperienced VCs to show off a home run. This behavior is coined grandstanding by Gompers (1996), and also include the fact that investments that are taken to the market too early will be underpriced. Support for this observation is given by Neus and Walz (2005), who assert that young VCs may have an incentive to underprice in order to gain a reputation.

Esbenlaub et al. (2009) also observe that young VCs hold their investments for a shorter period of time than their more experienced counterparts, indicating support for the grandstanding hypothesis.

But reputation is not the only factor influencing time to exit. The activity in the market plays an important role (Giot and Schwienbacher, 2007; Rossetto, 2008; Shepherd and Zacharakis, 2001), and a hot market significantly shortens the time to exit. There are two explanations for this. Number one, a hot market is more liquid and it will be easier to find potential buyers of a company, be it through an IPO or a trade sale. Number two, there are often more potential good deals around in a hot market, giving the VCs an incentive to exit their current investments in order to free up human capital for new investments. Rossetto (2008) makes an interesting observation, namely that companies with venture capital backing is less likely to be underpriced during normal periods, but that the opposite is true for hot issue periods. This might suggest that VCs have a better ability to price their companies correctly than other actors in the market, but deliberately choose to underprice during hot markets in order to get access to new capital.

Giot and Schwienbacher (2007) show that the degree of value-adding from the VCs positively influences the time to exit. This can be seen in the light of Esbenlaub et al. (2009), who claim that syndication decreases the time to exit. These two observations can be combined, since it is highly likely that a syndicate of VCs will have a larger knowledge reservoir (Widding, 2005) and therefore will be able to add more value to the venture. The observation regarding syndication should also be viewed in the light of social capital, an area which we will return to shortly; syndication will provide a larger network, increasing the possibility of finding potential buyers, and hence speed up the exit process.

Geography is another factor influencing time to exit. Shepherd and Zacharakis (2001) find that companies located in the West and Midwest of the U.S. have shorter times to exit than in the Northeast. A possible explanation for this is what they call a strong ecosystem, which both provides a nurturing environment and an increase in the birth rate of new organizations. Support for the impact of geographical location is given by Esbenlaub et al. (2009), who find that companies in the U.S. are exited faster than in the UK and the rest of the world.

The concept of staged financing, described in detail in the following section, is closely connected to the evaluation of achieved milestones. Giot and Schwienbacher (2007) show that the achievement of milestones accelerates exit for all exit routes. Milestones give the VCs an opportunity to evaluate the quality of their investments. If they are developing the right way, more money and resources can be invested, hence accelerating the exit. If the venture is not developing as planned, judged by milestones, they may choose to divest through a liquidation in order to limit losses and free up any capital that can be salvaged from the failure.

A final interesting observation is made by Lin and Smith (1997): venture capital-backed companies are taken public at an earlier stage than other companies in general, hence making the VC himself a factor influencing time to exit. This is explained by the fact that VCs have limited resources in the form of advisory talent available to them. In order to free up these resources for other investments, they choose to push for an exit. This offers an alternative to the grandstanding hypothesis, although not mutually exclusive.

The time to exit of a given portfolio venture thus appears to be influenced by a multitude of variables; some given by the external environment and some more inclined to active manipulation by the VC.

Legality and Control

Introduction

The risk associated with investing in early-stage ventures is pronounced (Sahlman, 1990). The failure rate among such companies is high, and on average as few as two out of ten ventures succeed (Zider, 1998). VCs themselves seem to be confident that the main reason for these failures is shortcomings in the senior management of the portfolio companies (Gorman and Sahlman, 1989).

It is not surprising then, that VCs use different mechanisms to reduce the risk, and to increase the control over the portfolio companies' destinies (Kaplan and Strömberg, 2003; Zider, 1998). In fact, different types of control rights are correlated with, and facilitate, exit outcomes (Cumming, 2008). Additionally, the institutional and legal factors in a geographical region can influence the risk associated with investing in private ventures (Cumming et al., 2006).

Main Findings

Some parts of the literature emphasize the Legality in a country as a determinant of exit possibilities (Cumming et al., 2006; Isaksson, 2000; Schwienbacher, 2005; Wang and Sim, 2001). Legality is an index derived by different law and finance factors, such as the judicial system, the rule of law, corruption, and shareholder rights, as described by La Porta et al. (1997; 1998; 2000). Empirical evidence gives support for the influence Legality places on exit: high quality legal environments give rise to successful exit environments, and an increase in the Legality index increases the probability for exiting through an IPO (Cumming et al., 2006).

A possible explanation could be that countries with better protection of shareholder rights have more developed equity markets (Cumming and Johan, 2008). In addition, Cumming and Johan (2008) find that Legality is associated with governance structures, such as syndication and board seats, which in turn are positively related to the probability of an IPO.

The VC and the entrepreneur may have different preferences with respect to which exit vehicle to employ (Cumming, 2008; Cumming and Johan, 2008; Hellmann, 2006). The entrepreneur is often assumed to prefer an IPO, because it is more likely that he continues to control the company in such a case. The VC, on the other hand, may actually prefer a trade sale in some cases (Cumming, 2008; Cumming and Johan, 2008; Hellmann, 2006). In order to cope with this misalignment of interests, VCs use different kinds of governance mechanisms (Cumming, 2008; Cumming and Johan, 2008).

These governance factors may include board positions, control rights, veto rights, and security design (Cumming and Johan, 2008; Sahlman, 1990). Control rights are for example co-sale arrangements, drag-along rights and anti-dilution protection (Cumming and Johan, 2008). Examples of veto rights are the right to prohibit asset sales, asset purchases, issuances of equity and changes in control (Cumming and Johan, 2008).

Research shows that such governance factors influence exit vehicles. When the exit strategy is pre-planned, a trade sale exit is associated with stronger control and veto rights (Cumming and Johan, 2008). Likewise, trade sale exits, pre-planned or not, are associated with stronger control rights (Cumming, 2008). This is in line with the arguments made related to the misalignment of interests between the VC and entrepreneur presented over. Moreover, IPO exits are associated with weaker control rights. This is also true for ventures that are liquidated (Cumming, 2008).

Most VCs assume a position on the board when investing, and board positions seem to play an important role in determining exit (Kaplan and Strömberg, 2003; Sahlman, 1990; Smith, 2005; Williams et al., 2006). More specifically, the board is often the institution in the company that is authorized to initiate exit decisions (Smith, 2005).

Another widely used mechanism by VCs to reduce the risk associated with investing in early-stage ventures is convertible preferred securities (Kaplan and Strömberg, 2003; Sahlman, 1990; Smith, 2005). Hellman (2006) shows that convertible preferred securities may affect the exit, by allocating different cash flow rights for IPOs and trade sales. An optimal contract may in fact give the VC more cash flow rights in a trade sale (Hellmann, 2006). Pre-planned trade sale exits are more likely to be associated with convertible securities and have a lower likelihood of using common equity (Cumming and Johan, 2008).

Should the venture performance be extremely disappointing, and it becomes necessary to liquidate the firm, VCs use liquidation 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).

A final method to obtain control over the portfolio companies is capital staging (Gompers, 1995; Sahlman, 1990). The concept is that the portfolio company is only granted enough money to reach the next milestone (Schwienbacher, 2005). If the portfolio company reaches the next stage, more money is likely to be invested. When considering infusing additional capital, the VC gathers information, and staging of capital therefore becomes a monitoring device (Gompers, 1995). This practice is disciplinary and provides incentives to the entrepreneur. Misuse of capital becomes costly for the entrepreneur, because more capital will be invested at a lower valuation, reducing the entrepreneur's stake. Further, staging of capital gives the VC the option to abandon the project completely if it is performing badly (Sahlman, 1990).

The extent of rights used may vary by the entrepreneur, the VC and the nature of the firm. For instance, more experienced entrepreneurs receive venture financing with less control rights, and more experienced VCs are more likely to use convertible securities (Cumming, 2008; Cumming and Johan, 2008). This is straight-forward, because experienced entrepreneurs often have a track-record that reduces the risk for the VC. Also, VCs are more likely to use control rights in a venture that operates in a high-tech industry, and less likely to use such mechanisms in ventures in the earlier stages (Cumming, 2008). High-tech industries are often associated with higher risk, and the VC may therefore find it natural to increase the level of control in such ventures.

In conclusion, it is evident that the institutional factors and governance mechanisms imposed by VCs influence both the exit possibilities and the exit vehicle.

Adding Value

Introduction

In general, VCs are active investors, spending considerable time on their portfolio companies (Steier, 1998). Gorman and Sahlman (1989) found that most VCs spend more than half of their time actively involved with their portfolio companies. In the post-investment phase, the VC involves himself in two main activities: monitoring and value-adding activities (De Clercq et al., 2006). In order to monitor the investments, the VC often acts as a director of the company, in addition to requiring regular updates on the company status from the management team (De Clercq et al., 2006). Moreover, the VC may support his portfolio companies by conducting different kinds of value-adding activities. MacMillan et al. (1989) distinguish between four areas of involvement: development and operations, management selection, personnel management, and financial participation.

The value that VCs add to the portfolio companies helps justify the expensive capital they provide to entrepreneurial ventures (De Clercq et al., 2006; Zider, 1998). Ehrlich et al. (1994) support this statement: "Who the entrepreneur gets his/her money from is just as important as the amount of capital obtained initially." Gompers (1995) puts it this way: "Venture capitalists claim that the information they generate and the services they provide for portfolio companies are as important as the capital infused." However, he adds that: "Many entrepreneurs believe that venture capitalists provide little more than money."

These statements lead us to a central question that is sought answered in the research on value-adding: Do VCs add value? Efforts made to answer this question have led to inconclusive answers (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).

What is for certain is that VCs spend a considerable amount of their time actively involved with their portfolio companies; an activity that would make no sense should the VC himself doubt that he can add value to the entrepreneurial ventures. Therefore, while scholars thus far have been unable to give a definitive answer to the question of whether or not VCs add value to their portfolio companies, the conclusion can be drawn that the practitioners themselves believe that they can, and hence spend a considerable amount of their time on activities intended to do just that.

By taking the stance that VCs in fact can add value it is obvious that the degree to which they are successful in doing so affects the survival probability and success of the venture in question. Since successful exits are contingent on successful ventures, there might be a link between the value added and the exit process, warranting a review of the literature in this field.

Main Findings

According to several studies, the main value-adding activity for VCs is to help in financial and strategic matters (Ehrlich et al., 1994; Gorman and Sahlman, 1989; MacMillan et al., 1989; Sapienza et al., 1996). This may involve help in raising additional capital, providing strategic advice, and serving on a sounding board for the portfolio companies. Additionally, VCs may help with developing business plans and recruitment (Gorman and Sahlman, 1989; Zider, 1998).

Typically, VCs are not involved in the day-to-day operation of the portfolio companies (Gorman and Sahlman, 1989; MacMillan et al., 1989; Sapienza et al., 1996).

Overall, VCs are satisfied with the service they provide to their portfolio companies, and they would not have changed their behavior significantly if they could (MacMillan et al., 1989). If they had the chance, however, they would have increased their involvement in activities requiring minimal time commitment, and decreased their involvement in activities requiring considerable time (MacMillan et al., 1989). On the other hand, entrepreneurs mainly seek help from investors to manage the financial aspects of the firm, as well as conducting recruitment (Ehrlich et al., 1994). This shows that the supply of expertise from VCs is to a large degree in line with the demand for expertise from entrepreneurs.

Another aspect that influences the value of advice from VCs is entrepreneurial ventures' openness to advice. Barney et al. (1996) found that the success of nonfinancial assistance depends partly on how much value the management team puts on advice from VCs. This raises an interesting question: Do entrepreneurs in general see value in the advice and activities of the VC? And if the answer is no, could this be part of the reason why entrepreneurs mainly seek help to manage the financial aspects of the firm? Under the assumption that openness to advice affects the value added from the VC, the demand for advice could also be greater from the entrepreneurs that are open to it. Thus, a reinforcing virtuous cycle of value-adding could be generated by having an open and demanding entrepreneur.

Other factors may also influence the degree of value added from the VC. For instance, VCs add more value to portfolio companies associated with pronounced uncertainty related to innovation and life cycle (Sapienza, 1992; Sapienza et al., 1996). However, value can be added in every stage of the companies' life cycles (Sapienza, 1992). It is also found that VCs with experience in the industry in which the portfolio firm operates, add more value than those who do not hold such experience (Sapienza et al., 1996). Firm performance may also influence the value ventures put on VCs' advice. Sapienza (1992) found a positive correlation between firm performance and the entrepreneur's evaluation of the value of VC involvement. 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.

Additionally, the human capital of VCs has been under scrutiny. Distinguishing general human capital, defined as an education within humanities and social sciences, and specific human capital, defined as an education within management and law, in addition to consulting experience, Dimov and Shepherd (2005) explored to which degree human capital influences investment performance. They found that general human capital was associated with a higher likelihood of an IPO, while specific human capital reduced the probability of a bankruptcy.

As mentioned, several studies show that VCs allocate a majority of their time to value-adding activities (Gorman and Sahlman, 1989; Zider, 1998). Typically, the lead investor in a portfolio company devotes more time to the investment than non-lead investors. However, a portfolio company may have a VC's attention only for an hour or two per week (Gorman and Sahlman, 1989; Zider, 1998). This means that VCs are not deeply involved in the day-to-day operations of their portfolio companies. However, 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).

The VC devotes different amounts of time to each of the portfolio companies (Sapienza et al., 1996). Typically, less time is allocated to the top performers in the portfolio, as well as the lemons (Zider, 1998). However, other studies show that it is in fact in the well-functioning companies the VC may add the most value (Sapienza et al., 1996). Companies in the early stages also receive more attention than older ventures (Sapienza et al., 1996).

Even though the average VC spends much time on value-adding activities, there are considerable differences between different VCFs. VCs may conduct laissez-faire involvement, moderate involvement, and close tracker involvement, where the investor exhibits more involvement than the entrepreneur in some activities (MacMillan et al., 1989). No differences in portfolio company performance were found with respect to the different levels of involvement (MacMillan et al., 1989). However, different types of involvement may require different types of activities in order to have a positive impact on venture performance. For laissez-faire involvement, developing a professional support group influenced performance positively, while monitoring operations had a positive influence when conducting moderate involvement. For the close tracker, negotiating employment terms with management added the most value (measured as venture performance) (MacMillan et al., 1989).

In conclusion, under the stance that the VC actually can add value apart from financial assistance, this value is influenced by various factors. Obviously, the more value that is added to the venture as it develops, the higher is the probability of it surviving and growing to become a successful company. As a result, a successful exit for the VC is more probable; indicating that value-adding factors cannot be disregarded when seeking to define the variables that affect exits.

Social Capital

Introduction

Human beings do not operate within a social vacuum. We are connected to others, and we have our own unique networks. The existence of such unique networks, in combination with personal characteristics of individuals, are among the factors making opportunity recognition possible (Kirzner, 1999). In addition, these networks are very important for both investor and entrepreneur in maximizing the rate of return achieved on their investments:

> Rate of return is keyed to the social structure of the competitive arena and is the focus here. Each player has a network of contacts in the arena. Certain players are connected to certain others, trust certain others, are obligated to support certain others, and are dependent on exchange with certain others. Something about the structure of the player's network and the location of the player's contacts in the social structure of the arena provide a competitive advantage in getting higher rates of return on investment (Burt, 2000).

These connections to others constitute the social capital of the individual, and the social capital of the people in the organization aggregate to the social capital of the organization (Burt, 2000). As such, the social capital of the VCF is the sum of the social capital of its partners and employees.

In addition to social capital, organizations bring financial and human capital to the competitive arena. However, there are some important characteristics of social capital that distinguishes it from the other two. First of all, social capital is never owned by a single individual or organization – instead it is jointly owned and determined by the parties in the relationship. Should your legal advisor decide to retire and withdraw from his professional network, the connection dissolves and the social capital inherent in the relationship is lost. Secondly, where both the financial and human capital are concerned with the investment term of the market production equation, social capital affects the rate of return. It is through the social capital of the firm that "… the opportunities to transform financial and human capital into profit [arises]" (Burt, 2000).

These statements are as true for a consulting firm selling its services as they are for VCs looking for good prospects to invest in and later exit from. In fact:

> Networks also feature prominently in the venture capital (VC) industry. VCs tend to syndicate their investments with other VCs, rather than investing alone. They are thus bound by their current and past investments into webs of relationships with other VCs. Once they have invested in a company, VCs draw on their networks of service providers – head hunters, patent lawyers, investment bankers, etc. – to help the company succeed (Hochberg et al., 2007).

Therefore, it is highly relevant to investigate the research literature on the connection between exit processes and the social capital of the VC. Even though a minimal amount of studies have been performed within this setting, some interesting results have been produced, and these will form the backdrop for our discussion regarding the effect of social capital on exit processes.

Main Findings

As previously stated, the reputation of the VCF, in terms of the firm being known for not exiting at overstated valuations, is important for alleviating a large problem for VCs when exiting; namely that of information asymmetry between seller and buyer. As such, social capital has the potential to lower the information asymmetry, as the reputation of a VC is an inherent part of his social capital.

However, social capital can have an even more direct influence on the problem of asymmetrical information. As shown by Gompers and Xuan (2009) in their study of acquisitions of private companies by public acquirers, VCs can function as bridge builders between the acquiring firm and the target. In situations where both the acquirer and the target have been financed by the same VCF, the likelihood that a transaction will be all-equity financed as well as the likelihood that a transaction will take place at all both increase significantly. Furthermore, the acquisition announcement returns are significantly higher for such transactions when benchmarked against transactions where the VCF has no financing history with the acquirer.

The strong social relationships the VC has with both the acquirer and the target thus allows him to act as a bridge builder, credibly conveying information between the two firms through his personal relationships. The information asymmetry associated with the transaction is reduced for both parties, increasing the likelihood of a successful acquisition. Importantly, this effect of the social capital of the VC is especially valuable in situations where the asymmetric information problem is especially severe; that is where the firms are geographically dispersed (putting a restraint on the ability to "kick the tires" of the target) and where the target is young (thus having little history of performance and market standing to show to) (Gompers and Xuan, 2009).

Furthermore, Hochberg et al. (2007) comprehensively show that networks are the predominant choice of organizational form for VCFs. In fact, some VCFs even go as far as describing themselves as a venture keiretsu. These networks differ in their size and quality, with some VCs holding a more influential network position than others, "… implying differences in clout, investment opportunity sets, access to information, etc. across VCs" (Hochberg et al., 2007). As such, having a central position in the network does not only improve the access to deal flow. Well-networked VCs are found to perform better as they are able to provide higher quality value-adding services to the ventures they invest in, with the result that these portfolio companies are significantly more likely to survive to an eventual exit.

However, the social capital of the VC does not only affect the potential for successfully exiting. As we have mentioned earlier, VCs are as a rule of thumb not able to sell their stake in a venture immediately following an IPO. Instead, they typically gradually divest their holdings over a period of months and even years. As a result, then, the ability of the firm to survive after going public may also be an important determinant of the success of the exit for the VCF. Fisher and Pollock (2004) show that a higher proportion of investors included in the deal network at the time of transforming the company from private to public that have embedded ties to the lead underwriter has a positive effect on the likelihood of survival for the IPO firm. This is due to the fact that embedded investors allocate higher credibility to the claims made by the underwriter, increasing their tolerance of short-term variance in performance following the IPO (Fischer and Pollock, 2004). Thus, they are willing to hold on to the stock for a longer period of time, providing stability in the stock price and allowing the company to focus on strategic and operational activities (Rao and Sivakumar, 1999).

Therefore, Fisher and Pollock (2004) conclude that:

> Finally, when selecting an underwriter to lead their IPO, managers should carefully consider not just the reputational capital of underwriters, but also the social capital reflected in their networks of relationships with institutional investors and the likelihood they will use their social capital on the firm's behalf to construct an embedded deal network.

However, we know that the VC typically holds at least one seat on the board of directors, and has a significant influence over important management decisions (such as the decision to go public) through his ownership stake as well as through special provisions in the investment contract. In addition, VCs with exit experience have personal relationships with both underwriters and institutional investors. Therefore, it is logical that the VC also plays an important role when it comes to the choice of who should be the lead underwriter for the IPO firm – and that the social capital of the VC will be an important determinant of which firm is chosen. Furthermore, having a VC onboard with embedded relationships with both underwriters and institutional investors should also mean that a higher credibility is allocated to the information relayed about the IPO firm. Thus, the social capital of the VC can play an important role in providing stability for the IPO firm – increasing its likelihood of survival post-IPO. This view is supported by the fact that venture capital-backed firms are more likely to survive IPOs than non venture capital-backed companies (Jain and Kini, 2000).

There is little doubt that the social capital of the VC has a significant effect on several aspects of the exit process. Hochberg et al. (2007) find that:

> … VCs that are better-networked at the time a fund is raised subsequently enjoy significantly better fund performance, as measured by the rate of successful portfolio exits over the next 10 years.

The famous proverb "It is not what you know, but who you know" seems to have some clout also when it comes to the VC and his exit process.

Mergers and Acquisitions

Introduction

Most of the research done with regards to exit processes is focused on IPOs. With trade sales being the most common exit route for VCs, exhibiting a strong growth over the past 10 years (Chaplinsky and Gupta-Mukherjee, 2010; Wall and Smith, 1997), it is evident that attention needs to be paid to this exit route as well. In order to get a broader perspective on exits, this chapter will take a closer look at the exit process from an M&A perspective.

Most M&A literature have been interested in the buyer's perspective, with the goal of identifying factors that determine the acquirer's degree of success (Graebner and Eisenhardt, 2004). Previous research also tends to be focused on the acquisitions of public firms (Capron and Shen, 2007). However, with the goal of this study in mind, this section will rather focus on factors that are of importance to the VC and entrepreneur, in order to create the most value when conducting an exit through a trade sale of a privately held company.

Main Findings

The first interesting finding from these articles concerns the timing of the decision to sell. Graebner and Eisenhardt (2004) suggest that the motivation of the management of the selling company mainly comes down to two factors, namely strategic hurdles and strong personal motivations. 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 (Graebner and Eisenhardt, 2004). Managers who experienced one or more of these factors were shown to have a high interest in being acquired (Graebner and Eisenhardt, 2004). 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.

Capron and Shen (2007) look at the trade sale mainly from the buyer's point of view, but their findings have some interesting implications for sellers of private firms. Most striking is perhaps the observation that due to information asymmetry leading to a higher perceived risk, a private firm discount exists. The authors point to a lack of visibility and lack of managerial ability to convey the value of their assets, in addition to a lack of negotiation skills and low acquisition experience, and suggest 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.

Interestingly, Stuart et al. (1999) argue that an acquirer can use the quality of third-party endorsements to assess the quality of young, newly public firms. This might also hold some truth before the firm has gone public, and hence offer some support to Wall and Smith (1997).

However, caution needs to be taken when choosing these intermediaries. Kesner et al. (1994) argue that the use of investment bankers reduces the cost of searching by matching buyers and sellers, that they reduce information asymmetry, and also provide technical expertise improving the efficiency and effectiveness of negotiations. But, when looking at this process by using agency theory, there might be a misalignment of interests. The bankers often get paid a percentage of the total value of the deal, both when representing the target and the bidder. This means that the goals of the seller and the investment bankers seemingly are aligned, under the assumption that both want to receive the maximum price possible for the shares. However, the bidder wants to minimize the price paid for the target firm, indicating misaligned interests.

This might seem as a problem not concerning the seller, since Kesner et al. (1994) argue that the incentives for the seller and the investment bank are aligned. However, according to Graebner and Eisenhardt (2004) the sellers are more concerned about selecting buyers that offer a synergistic combination potential and organizational rapport than they are with selecting the potential buyer offering the highest price. And most surprisingly, the investors and the board actually share this concern. The selling leaders were described in the following way:

> … the selling leaders saw acquisition as a way to prosper through partnership, not as organizational death. They were attracted to compatible buyers, suggesting that courtship perhaps creates a subtle trade-off between acquisition price and organizational death (Graebner and Eisenhardt, 2004).

Hence, there is clearly a conflict between Kesner et al. (1994) and Graebner and Eisenhardt (2004). Without taking sides, the fact is that a conflict of interest between the principal and agent might arise, and the VC and entrepreneur need to be aware of this. This also becomes evident when looking at Petty et al. (1994), who show that entrepreneurs mostly relied on their staff and advisors when determining a fair price for their company, and that they often were disappointed with the advice given by the experts.

Petty et al. (1994) also take a closer look at the post-exit phase, with emphasis on the entrepreneur. It turns out that entrepreneurs exhibit a significant disappointment with the exit process and its final outcome. A feeling of disillusionment often arose, especially when the entrepreneur continued to work in the management of the new firm under supervision of the new owners. One might think that the increased liquidity that often comes with an acquisition motivates the entrepreneur, but Petty et al. (1994) show that the opposite often is the case; the entrepreneur saw the management of the new liquidity as a burden. Overall, this paints a picture of an entrepreneur who is inexperienced when it comes to exit processes. This is especially evident with regards to the implications the exit has for the future, both for the entrepreneur himself and for the company he is managing.

Discussion

The review of the literature covering aspects of the exit process has generated some interesting insights. First of all, the VC's divestment of his portfolio companies is a complex process influenced by a host of different variables. As such, no simple model can adequately describe all of the aspects influencing the exit process. Secondly, there seems to be a clear gap in the research-based knowledge about the exit process. While we have covered a large amount of articles shedding light on the venture capital exit process, no overarching model of the process itself has been uncovered.

Instead, articles typically cover one specialized theme – such as which factors might influence the choice of exiting via a trade sale rather than an IPO. Perhaps this lack of an overview of the entire process is due to the complexity of the exit process combined with the sensitivity of the data involved. However, a better picture of what actually influences the exit process, along with an understanding of how this influence affects the exit, could potentially decrease the current exit failure rates. Such a contribution could therefore be immensely valuable to the venture capital community. Therefore, based on our findings from the literature review, our first steps towards generating such an overarching model are presented below.

The model, named "The Road to Venture Capital Exit", divides the VC investment activity process into three distinct steps; pre-investment, post-investment, and exit phase, following De Clercq et al.'s (2006) convention. The relevant variables from each of the categories developed during the literature review are indicated for each step. It is also indicated whether the variable is viewed as being exo- or endogenous. However, as indicated in the following discussion, it is not always easy to draw a clear distinction between exo- and endogenous variables. In our model, the exogenously given variables are presented on the right. The endogenous variables are presented along with ambiguous variables on the left.

Due to the vast number of variables identified, they have been categorized into six distinct categories based on their individual characteristics. These categories are: *Economic*, *Governance*, *Network*, *Strategic*, *VCF-specific* and *Venture-specific*. Which variables that have been classified as belonging to which category is indicated in the model below. The authors hope that this classification will make later, empirical research more practical, as it illustrates some abstracted categories that enact high influence on the venture capital exit process. Such abstracted categories may lend themselves more easily to empirical inquiries than the individual variables identified. Appendix 1 gives a more thorough presentation of each variable.

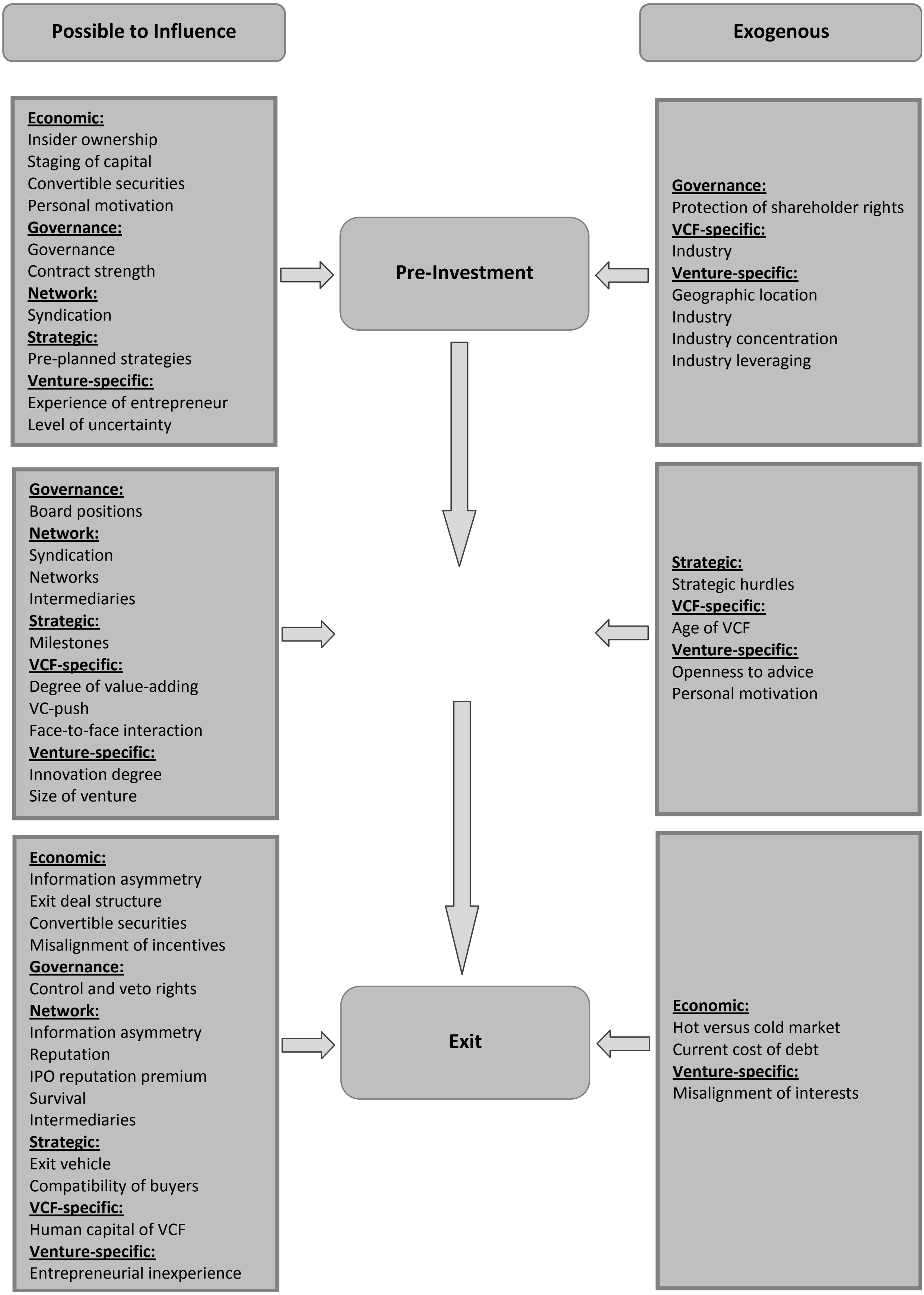

Figure 1: The Road to Venture Capital Exit

The first thing we had to consider when trying to generate this model was whether or not it was enough to solely look at the final phase of the venture capital investment activity process. In other words, is it possible to understand all of the determinants of the exit process by only looking at the exit phase of the process? This phase has been called the exit phase for a reason, and there is little doubt that many highly important decisions are made during this critical time. Furthermore, in the interest of creating a parsimonious model, it would be beneficial to be able to focus on only the last step in the investment activity process. However, the review has uncovered variables that have a high influence on the exit process, but that nevertheless are determined long before the venture enters the exit phase. Some of these are locked in already at the pre-investment phase, while others have their highest influence during the post-investment phase.

For instance, whether or not the VC utilizes convertible securities is decided as he structures the deal before investing. However, the use of convertible securities affects exits by allocating different cash flow rights to the VC dependent on whether the exit vehicle is an IPO or a trade sale (Hellmann, 2006). Similarly, the VC decides how much time he wishes to spend on face-to-face interaction with the entrepreneur during the post-investment face. However, the more time he spends on such interaction, the higher the degree of value-adding (Sapienza, 1992; Sapienza et al., 1996), and the higher the degree of value-adding, the lower the time to exit (Giot and Schwienbacher, 2007).

Obviously then, variables that are locked in the pre-investment and post-investment phase of the venture capital investment activity process do influence exits. The critical takeaway is therefore that one must take a step back and consider issues from the entire investment activity process when trying to model the exit process; focusing only on the exit phase means overlooking many of the determinants that are the underlying reasons for the choice set available to the VC at this late stage.

A second point of consideration is which variables that are open to manipulation. While knowledge about all of the various variables influencing exit processes obviously is important, the variables of the most interest for practitioners are undoubtedly those where they actively can make a difference. The question is therefore whether such a distinction can be made, and if so, which variables are open to manipulation and which are given by the external environment?

There can be little doubt that some variables are completely outside the VCs control sphere. A hot equity market, for instance, does push down the time to exit (Giot and Schwienbacher, 2007; Shepherd and Zacharakis, 2001) and increases the likelihood of exiting via an IPO (Brau et al., 2003). As such, hot equity markets do have a significant effect on the venture capital exit process. However, it is obvious that this is a variable outside of the VC's control sphere. Markets vary from hot to cold on the account of many variables, but even the most confident VC could not claim that his decisions have a significant influence on this variation. Similarly, a high industry concentration in the industry of the portfolio company is positively related to the probability of exiting via an IPO (Brau et al., 2003). Again, the relevant industry concentration is clearly a variable that is given at the time of the VCs investment. Obviously then, some of the variables influencing exits are out of the VCs control.

At the other end of the scale there are some variables that obviously do lie within the VCs control sphere. VCs can, for example, substantially decrease the information asymmetry associated with a trade sale by actively seeking to act as a bridge builder between the seller and the buyer (Gompers and Xuan, 2009). High information asymmetry is associated with a private firm discount in trade sales (Capron and Shen, 2007), and as such directly affects the value of the exit. Similarly, VCs can actively seek to syndicate their investments, and syndication decreases the time to exit (Espenlaub et al., 2009). As such, there is little doubt that the VC can actively influence some of the variables that affect exits.

However, many of the variables uncovered during our literature review do not lay themselves open to such an easy classification. Consider, for example, the experience of the entrepreneur variable. A more experienced entrepreneur is associated with less control rights for the VC (Cumming, 2008; Cumming and Johan, 2008), and weak control rights are associated with IPO exits (Cumming, 2008). As such, the experience of the entrepreneur does have an effect on exits. The question is, then, can the VC actively influence the experience of the entrepreneur?

Obviously, the experience of the entrepreneur at the time the deal is presented to the VC is given. No active influence can be exerted by the VC to change what the entrepreneur has experienced prior to meeting him. However, it is a known fact that VCs often take an active role in choosing the management of their portfolio companies. Therefore, the VC can play an active role in determining who should be the CEO of a given portfolio company, and as an extension, highly experienced individuals can be given the role of entrepreneur by the VC. Thus, it is ambiguous whether or not the VC actively can influence the experience of the entrepreneur.

Similarly, the size of a portfolio company (in terms of the total asset value) influences the choice of exit vehicle, with larger ventures being associated with a higher probability of going IPO (Brau et al., 2003). This variable is partly determined by factors outside the VCs control; it is clear that a venture developing an online service will have a lower total asset value than a company developing and producing a novel floating offshore wind turbine. At the same time, the VC often plays an active role in developing the strategy of the venture, with the business model as one important variable. A business model relying heavily on outsourcing obviously will lead to a lower total asset value of the venture than one that is based on keeping activities in-house. Again, whether or not the VC can actively influence the size of the portfolio company, and to which degree, is ambiguous.

As a result, we therefore end up with three classes of variables; those that are completely outside the VCs control sphere, those that are open to manipulation by the VC, and those that are ambiguous with respect to which degree the VC can actively influence them.

This distinction between variables is important, as it allows the actors in the process to focus on the variables where influence can be enacted to change the outcome of the process, while still allowing for the inclusion of all of the relevant variables in the analysis. However, it is important to note that the classification of the variables is based on the subjective evaluation of the authors, and as such is in need of empirical verification.

A final point of consideration is whether or not the model is dynamic. As it is presented, the model appears rather static. The level of insider ownership is, for example, given as a variable that is determined in the pre-investment phase. However, while insider ownership without a doubt is influenced by the original terms of the investment, it is easy to imagine ways for this variable to be changed as the venture develops. The board may for instance award stock options or equity to the management team during the post-investment phase based on the achievement of specific milestones. Similarly, syndication is given as a variable that is determined in both the pre-investment and the post-investment phase. This is logical as syndication of the deal can occur both at the time of initial investment and at later stages.

Furthermore, variables that are given to have a high influence in a certain stage might actually be partly responsible for entering this stage in the first place. One clear example would be whether or not there is a hot market, which is shown to have a clear effect on both exit vehicle and timing (e.g. Brau et al., 2003; Giot and Schwienbacher, 2007; Gompers, 1996; Rossetto, 2008). In our model, this variable is shown to influence the exit phase of the investment activity process. This is based on the fact that it is the temperature of the market as the venture is exited that enacts influence. A hot market two years (or for that matter two weeks) before exiting will lend little help if the current market is cold. However, it is not hard to imagine that a current hot market is one of the reasons why the VC has moved into the exit phase. As such, the variable might affect the post-investment phase by actively ending it.

It is therefore expected that the proposed model indeed will be a dynamic one, where it should be possible to identify variables that assume new values as the venture develops, as well as where the value of certain variables actually might influence the stage of the exit process itself. Which variables are dynamic, and which are static, as well as the degree to which the original value can be changed, however, is not certain. Empirical research will be needed to shed light on these questions.

With these important clarifications as the backdrop, the first steps towards generating an overarching model of the exit process have been taken. As has been pointed out, many factors remain uncertain. Furthermore, we cannot draw the conclusion that all relevant variables have been uncovered. For that, our data is insufficient. We do believe, however, that these first steps are an important beginning that can create the foundation on which to build an overarching model of the venture capital exit process. Thus, we hope that the proposed model helps in paving the way for an increased research-based knowledge of this highly complex and important process. By having such an overview of variables influencing the eventual exit of the VC, along with an understanding of when each variable is open for manipulation and enacting its strongest influence, both VCs and entrepreneurs are better equipped for managing the exit process and achieving the extremely important successful exit.

Conclusions and Implications

The purpose of this paper was to develop an overarching model based on the following research questions: Which variables influence the venture capital exit process? During which phase of the venture capital investment activity process do these variables have their highest influence? And how do these variables influence the exit process?

To answer these questions, we have conducted a thorough literature review. The literature covered in the review is grouped into six categories: *Choice of Exit Vehicle*, *Time to Exit*, *Legality and Control*, *Adding Value*, *Social Capital* and *Mergers and Acquisitions*.

The review has identified several variables that influence exits. These variables have been grouped into six new categories: *Economic*, *Governance*, *Network*, *Strategic*, *VCF-specific* and *Venture-specific*, and according to which phase of the venture capital investment cycle they belong: the pre-investment, the post-investment or the exit phase.

This grouping has led to a theoretical model, known as "The Road to Venture Capital Exit". The model suggests that variables that influence exit may be apparent both in the pre-investment, the post-investment and the exit phase. Further, the model acknowledges that there are certain variables that are exogenous, and certain variables that the VC can influence. Finally, the proposed model acknowledges that some of the variables may be of a dynamic nature.

Implications for Practitioners

One of the motivations behind this study was the pronounced difficulties VCs have with exiting their investments (Ghalbouni and Rouizes, 2010; Wall and Smith, 1997). Hopefully, the different variables identified in this paper can help the VC evaluate his potential investments better. However, a mere descriptive framework as ours can only act as a checklist, and a more prescriptive model is needed in order to provide more exact advice. One takeaway for the VC could be that exit is not the process that starts when the decision to sell is made; exit is a longitudinal process which starts already in the pre-investment phase, and almost every decision made throughout the investment cycle has the potential to influence the final outcome of the exit.

For the entrepreneur it might seem confusing that the focus of the VC is on exiting, even before the investment has been made. However, due to the nature of venture capital funding, it should not come as a surprise that VCs seek to maximize their returns. In fact, a successful exit only means that the VC and entrepreneur have performed well, and will in most cases be a driver for further growth of the company. Perhaps the findings in this report can make the entrepreneur even more aware of how the VC thinks and acts, and help him both adapt to and support the strategic choices of the VC. As a matter of fact, a successful exit will in most cases mean that the entrepreneur himself has a lucrative choice – either to walk away with his share, or continue to work in a company that has gained momentum from the exit.

Implications for Further Research

This study has identified a clear gap in the research-based knowledge of the venture capital exit process; which variables affect exits, how they influence the process and when this influence is the greatest is not covered sufficiently in the current literature. The authors have taken the first steps towards generating an overarching model of the exit process, but many questions remain.

The variables found have been classified as endogenous and/or exogenous based on a subjective evaluation by the authors. Further research is warranted on which variables the VC actually is able to influence, and to which degree he is able to shape the variable to his liking. Similarly, we make no statement about which variables have the highest influence. There can be little doubt, however, that some variables will be more important than others, warranting a study of which variables are the most important determinants of the exit process.

Another interesting point is the fact that the geographic location of the portfolio company is found to have a significant influence on the exit process. A fundamental question is therefore whether an overarching model that is valid for several different countries can be built at all? Thus, a study is warranted on the applicability of the proposed model in different geographical settings.

Furthermore, the literature reviewed is overly focused on the IPO exit vehicle. Taking into account the domination of the trade sale exit vehicle observed, current research has not covered sufficiently this important exit vehicle. In fact, our literature review identified only one article specifically focused on venture capital trade sales. Thus, there exists a significant gap in the research-based knowledge on this topic. This black box offers a multitude of interesting opportunities for scholars to pursue.

To answer these questions and many more one has to turn to the empirical world, studying how the proposed model actually fits with the reality described by the VCs themselves. In addition, it would be interesting to look at the process from the view of the entrepreneur to understand his take on the venture capital exit process.

Scholars also need to consider the trade-offs involved with regards to methodology; where a broad study based on structured surveys and quantitative data may offer greater possibilities for generalizable conclusions, a narrower, qualitative study will no doubt offer greater insights. The complexity of the venture capital exit process and the vast number of variables identified that influence this process puts forward considerable challenges when considering the former research strategy. However, the sensitivity of the data involved may indicate that the latter strategy of gathering in-depth, qualitative data will encounter its own problems. In conclusion, scholars will have to make their own evaluation of the trade-offs involved based on their particular research question.

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Appendix 1 – Variables Influencing the Exit Process

Venture Capital Investment Activity Process	Choice of Exit Vehicle	Time to Exit	Legality and Control	Adding Value	Social Capital	Mergers and Acquisitions
Pre-Investment	**Geographic location** (exogenous) – the exit vehicle is influenced by the geographic location of the venture (Isaksson, 2000; Schwienbacher, 2005; Wang and Sim, 2001) **Industry concentration** (exogenous) – a high industry concentration is positively related to the probability of exiting via an IPO (Brau et al., 2003) **Industry leveraging** (exogenous) – being affiliated with a high market-to-book and/or highly leveraged industry is positively related to the probability of being acquired (Brau et al., 2003) **Insider ownership** (endogenous) – a high insider ownership is positively related to the probability of exiting via an IPO (Brau et al., 2003)	**Geographic location** (exogenous) – companies in the U.S. are exited faster than in the rest of the world. In addition, regional differences exist within the U.S. (Espenlaub et al., 2009; Shepherd and Zacharakis, 2001) **Syndication** (endogenous) – VC syndication decreases the time to exit (Espenlaub et al., 2009) **Staging of capital** (endogenous) – staging of capital according to the achievement of milestones accelerates exit for all exit vehicles (Giot and Schwienbacher, 2007)	**Geographic location** (exogenous) – an increase in the Legality index of the country of the venture increases the likelihood of exiting via an IPO (Cumming et al., 2006) **Protection of shareholder rights** (exogenous) – countries with higher protection of shareholder rights have more developed equity markets giving rise to more successful exit environments (Cumming et al., 2006) **Governance** (endogenous) – the structure of governance factors influences the choice of exit vehicle (Cumming, 2008; Cumming and Johan, 2008)	**Industry** (exogenous) – VCs add more value to portfolio companies that operate in an industry in which they have experience (Sapienza et al., 1996) **Level of uncertainty** (endogenous) – VCs add more value to portfolio companies with pronounced uncertainty with respect to innovation and life cycle (Sapienza, 1992; Sapienza et al., 1996)	**Syndication** (endogenous) – VCs can utilize their social capital to syndicate deals with other relevant players (Hochberg et al., 2007)	**Personal motivation** (endogenous) – a high financial gain and/or a dilution risk for management positively affects their willingness to sell (Graebner and Eisenhardt, 2004)

	Industry (exogenous) – being affiliated with a high-tech industry is positively related to the probability of exiting via an IPO. Being affiliated with the financial services industry is positively related to the probability of being acquired (Brau et al., 2003)		**Experience of entrepreneur** (endogenous) – more experienced entrepreneurs are associated with less control rights for the VC (Cumming, 2008; Cumming and Johan, 2008) **Industry** (exogenous) – high-tech industry firms are associated with higher control rights for the VC (Cumming, 2008) **Convertible securities** (endogenous) – more experienced VCs are more likely to use convertible securities (Cumming, 2008; Cumming and Johan, 2008) **Contract strength** (endogenous) – strong contracts can mitigate poor law systems (Cumming and Johan, 2008) **Pre-planned strategies** (endogenous) – preplanned acquisition exits are associated with stronger control and veto rights (Cumming and Johan, 2008)			

Post-Investment	**Innovation degree** (endogenous) – the higher the innovation degree, the higher the chance of going public via an IPO (Schwienbacher, 2008) **Size of venture** (endogenous) – a large venture is positively related to the probability of exiting via an IPO (Brau et al., 2003)	**Age of VCF** (exogenous) – younger VCs are more likely to push for an IPO and exit at underpriced values to build reputation (Espenlaub et al., 2009; Gompers, 1996; Neus and Walz, 2005) **Degree of value-adding** (endogenous) – the higher the degree of non-financial value-adding from the VC, the lower the time to exit (Giot and Schwienbacher, 2007) **Syndication** (endogenous) – VC syndication decreases the time to exit (Espenlaub et al., 2009) **VC push** (endogenous) – VC-backed companies go public earlier than other companies (Lin and Smith, 1997) **Milestones** (endogeneous) – the achievement of milestones accelerates exit for all exit vehicles (Giot and Schwienbacher, 2007)	**Syndication** (endogenous) – syndication of the investment is positively related to the possibility of an IPO (Cumming and Johan, 2008) **Board positions** (endogenous) – the board is the institution authorized to initiate exit decisions, and VC representation on the board significantly influences exit (Kaplan and Strömberg, 2003; Sahlman, 1990; Smith, 2005; Williams et al., 2006)	**Face-to-face interaction** (endogenous) – a higher amount of face-to-face interaction between VC and CEO positively affects value-adding (Sapienza, 1992; Sapienza et al., 1996) **Openness to advice** (exogenous) – the potential for non-financial value-adding is positively influenced by the value the management team puts on VC advice (Barney et al., 1996)	**Networks** (endogenous) – better networked VCs are able to offer higher quality value-added services, making survival to an eventual exit more likely (Hochberg et al., 2007; Sætre, 2003) **Intermediaries** (endogenous) – VCs can connect important value-adding intermediaries and the focal venture (Hochberg et al., 2007)	**Strategic hurdles** (exogenous) – the presence of strategic hurdles positively affects the motivation of the management to sell (Graebner and Eisenhardt, 2004; Petty et al., 1994) **Personal motivation** (exogenous) – fear of failure or stress for the management positively affects the motivation of the management to sell (Graebner and Eisenhardt, 2004)

Exit	**Hot versus cold market** (exogenous) – a hot market shows a clear positive correlation with exiting via an IPO (Brau et al., 2003) **Cost of debt** (exogenous) – a high current cost of debt is positively related to exiting via an IPO (Brau et al., 2003) **Information asymmetry** (endogenous) – the higher asymmetry the higher the chance of a partial exit to signal quality (Cumming and MacIntosh, 2003) **Exit deal structure** (endogenous) – greater liquidity offered by the deal to the selling insiders is positively related to the probability of being acquired (Brau et al., 2003)	**Hot versus cold market** (exogenous) – a hot market is correlated with a shorter time to exit (Giot and Schwienbacher, 2007; Rossetto, 2008; Shepherd and Zacharakis, 2001) **Exit vehicle** (endogenous) – the choice of exit vehicle influences time to exit, with an IPO as the quickest exit route (Espenlaub et al., 2009) **Reputation** (endogenous) – in order to maintain his reputation the VC may exit only partially until true market value of firm is revealed to avoid selling overpriced shares and hurting his reputation (Lin and Smith, 1997; Neus and Walz, 2005)	**Control and veto rights** (endogenous) – strong control and veto rights are associated with acquisition exits, while weak rights are associated with IPO exits (Cumming, 2008) **Misalignment of interests** (exogenous) – the entrepreneur is assumed to prefer IPO, while the VC prefers acquisition in certain cases. In order to cope with these differences VCs use governance (Cumming, 2008; Cumming and Johan, 2008) **Convertible securities** (endogenous) – convertible securities affects the choice of exit vehicle by allocating different cash flow rights for the VC for IPOs and acquisitions, making an optimal contract for both VC and entrepreneur possible (Hellmann, 2006)	**Human capital of VCF** (endogenous) – general human capital is associated with a higher likelihood of an IPO, specific human capital is associated with a reduced probability of bankruptcy (Dimov and Shepherd, 2005)	**Reputation** (endogenous) – exiting via an IPO or M&A has a positive reputational effect, increasing the probability of raising a follow-on fund (Chaplinsky and Gupta-Mukherjee, 2010) **IPO reputation premium** (endogenous) – exiting via an IPO carries a large "reputational premium" (Chaplinsky and Gupta-Mukherjee, 2010) **Survival** (endogenous) – better networked VCs are positively related to survival post-IPO (Fischer and Pollock, 2004; Jain and Kini, 1995) **Information asymmetry** (endogenous) – VCs can act as bridge builders, reducing information asymmetry. The reputation of the VC can also reduce the information asymmetry (Gompers and Xuan, 2009) **Intermediaries** (endogenous) – well networked VCs can connect the focal firm with important intermediaries for the exiting process (Gompers and Xuan, 2009; Hochberg et al., 2007)	**Information asymmetry** (endogenous) – high information asymmetry is associated with a private firm discount in acquisitions (Capron and Shen, 2007) **Misalignment of incentives** (endogenous) – a conflict of interest might arise between seller and selling intermediary (investment bank) (Graebner and Eisenhardt, 2004; Kesner et al., 1994) **Compatibility of buyers** (endogenous) – sellers seek compatible buyers, not necessarily the highest bidder (Graebner and Eisenhardt, 2004) **Entrepreneurial inexperience** (endogenous) – entrepreneurs are often inexperienced with M&A processes, and are often left disillusioned and disappointed after an acquisition (Petty et al., 1994)

Appendix 2 – Literature on Exit Vehicles

Author(s) Year Title	Journal	Purpose and Findings	Methodology
Bascha & Walz **2001** "Convertible securities and optimal exit decisions in venture capital finance"	*Journal of Corporate Finance*	The authors study the interaction between exit decisions and contract design in venture capital finance. Built on the premise that the VC and entrepreneur often have diverging opinions of different exit solutions, it is shown that convertible securities can help that the ex-ante agreed optimal exit policy is implemented.	Model development and analysis.
Brau, Francis & Kohers **2003** "The Choice of IPO versus Takeover: Empirical Evidence"	*The Journal of Business*	Examining factors that influence the choice between an IPO and a takeover by a public acquirer. Results show that the industry concentration, high-tech industry affiliation, current cost of debt, relative "hotness" of the IPO market, firm size and insider ownership percentage are all positively related to the probability of an IPO. In contrast, private companies in high market-to-book industries, financial service sectors, highly leveraged industries, and deals involving greater liquidity for selling insiders show a strong likelihood for takeovers. The results also indicate that a liquidity discount exists in takeovers relative to IPOs.	Empirical study of 4,683 firms that conducted a firm commitment IPO from 1984 to 1998 and 4,927 completed deals involving 100 % acquisition of U.S. private targets by U.S. public acquirers.
Cumming & MacIntosh **2003** "A Cross-Country Comparison of Full and Partial Venture Capital Exits"	*Journal of Banking and Finance*	The authors aim to explore when VCs make a partial exit instead of a full one. They consider the determinants of full and partial exit for all five exit vehicles. The central hypothesis of the paper; that the greater the degree of information asymmetry between the selling VC and the buyer, the greater is the likelihood of partial exit to signal quality, is supported. The data also indicates differences between the U.S. and Canadian venture capital industries, and emphasizes the impact of legal and institutional factors on exits across countries.	Empirical analysis of 112 VC exits in the U.S. and 134 VC exits in Canada during 1992-1995.
Isaksson **2000** "Venture Capital Exit Behavior in Sweden"	*Unpublished Conference Paper*	The author aims to explain the exit mechanisms used in Sweden to improve the understanding of venture capital exit problems. IPO exits are found to be the most preferred exit vehicle, while trade sales have been the most common. None of the government owned VCFs are found to be aiming for IPO exits. The majority of the firms in the survey show active exit behavior and thus indicates that exit behavior is an important part of the venture capital process.	Structured questionnaire sent to all VCFs identified in Sweden. Response rate of 60 % (23 firms).
Poulsen & Stegemoller **2008** "Moving from Private to Public Ownership: Selling out to Public Firms versus Initial Public Offerings"	*Financial Management*	The authors want to identify factors determining whether a venture goes public via IPO or by being acquired by a public acquirer. By considering firm-specific characteristics, such as growth, capital constraints, and asymmetric information, they find that firms go public via an IPO when they have greater growth opportunities and face more capital constraints.	Empirical study of 1,074 IPO and 735 sellout firms in the U.S., covering the period from 1995 to 2004.

Schwienbacher 2005 "An Empirical Analysis of Venture Capital Exits in Europe and the United States"	*Unpublished Working Paper*	The author aims to provide new, stylized facts about the venture capital industry in Europe and the U.S., with a focus on exits. He finds that there are many similarities, but some important differences include: duration of exit stage, the use of convertible securities, replacement of former management and deal syndication. Schwienbacher also finds that European VCs monitor less than their U.S. counterparts, and that some aspects of close monitoring seem to significantly affect the venture's likelihood of going public.	Structured questionnaires sent out to about 600 VCs in Europe and 600 VCs in the U.S. Response rates of 18 % for Europe and 11 % for the U.S. Data analyzed by using a regression analysis.
Schwienbacher 2008 "Innovation and Venture Capital Exits"	*The Economic Journal*	Investigates how innovation choices may affect exits. Finds that more innovative and profitable ventures are more likely to go public than ventures with more imitative or derivative projects. Thus, if the entrepreneur receives private benefits from remaining independent after the exit of the VC, he has incentives to favor business and R&D strategies that make an IPO more likely – leading to riskier strategies aiming at excessive innovation.	Model development and analysis.
Wang & Sim 2001 "Exit strategies of venture capital-backed companies in Singapore"	*Venture Capital*	The authors aim to explore the rationale of VCs in choosing a particular mode of exit for their investments. They find that firms in family owned, high-technology industries tend to exit via IPO. Wang & Sim also find contrasting evidence to the grandstanding hypothesis. The level of equity valuation is found to be independent of the likelihood that VC-backed companies will exit via IPO. Frequency of financing rounds is also found to be independent of the IPO exit.	Empirical analysis of VCFs that have exited from 1990-1998 in Singapore. Structured questionnaire covering 100 divestments. Case study with one firm to expand on data set.

Appendix 3 – Literature on Exit Timing

Author(s) Year Title	**Journal**	**Purpose and Findings**	**Methodology**
Esbenlaub, Khurshed & Mohammed 2009 "The Exit behavior of Venture Capital firms"	*Unpublished Working Paper*	Examining the exit behavior of UK VCFs from their portfolio companies based in the UK, the U.S., and the rest of the world. UK VCs prefer IPOs, followed by M&As and other routes. This preference is driven by the fact that IPO provides the fastest exit route. Experienced VCs hold their portfolio companies much longer than young VCs. Syndication reduces the time to exit. Portfolio companies based in the U.S. are exited quicker than in Europe and the rest of the world.	Empirical survival analysis using a frailty model, with a dataset of 5,059 investments in portfolio companies for 290 UK VCFs.
Giot & Schwienbacher 2007 "IPOs, trade sales and liquidations: Modeling venture capital exits using survival analysis"	*Journal of Banking and Finance*	The purpose is to examine the dynamics of exit options for U.S. venture capital funds. The study shows that hazard rates for IPOs are first sharply increasing, but then decreasing after a plateau is reached. For trade sales, the hazard function reaches its maximum later, and decreases more slowly. Achievement of milestones in past financing rounds and the degree of value-adding from VCs accelerates exit. Trade sales are significantly more likely for firms based in Silicon Valley and along Route 128, than in the rest of the U.S. Exits tend to be sped up during favorable IPO markets.	A modeling of exit times for IPO, trade sale and liquidation using a competing risks model on a sample of 20,000 investment rounds for 6,000 VC-backed firms.
Gompers 1996 "Grandstanding in the venture capital industry"	*Journal of Financial Economics*	Development and testing of the hypothesis that young VC firms take their investments public earlier than more established firms, a term labeled grandstanding. The motivation for this behavior is the building of reputation by signaling ability to go public, and to raise capital for new funds. The analysis shows that companies backed by young VC firms are in fact more underpriced at their IPO. In addition, young VC firms have been on the board of directors a shorter period of time at the IPO, they hold smaller equity stakes, and time the IPO with the raising of money for new funds.	Empirical regression analysis on a sample of 433 U.S. IPOs occurring between 1978 and 1987.
Lin & Smith 1998 "Insider reputation and selling decisions: the unwinding of venture capital investments during equity IPOs"	*Journal of Corporate Finance*	Four hypotheses are built, tested and confirmed. 1) Companies with VC investors are brought to the market at an earlier stage of development than other companies. 2) Ownership positions of venture capital investors are reduced substantially after an IPO. Monitoring responsibilities will decline correspondingly. 3) The likelihood of selling during the IPO depends positively on VC reputation and underwriter certification and negatively on the potential for overvaluation. 4) VCs with established reputations seek to maintain their reputations by selling shares in IPOs only if they perceive them not to be overpriced.	Hypothesis testing using a sample of 2,634 common equity IPOs from 1979 to 1990, where 497 were VC-backed.

Neus & Walz **2005** "Exit timing of venture capitalists in the course of an initial public offering"	Journal of Financial Intermediation	A study of the divestment decisions of VCs in the course of an IPO, examining why they do not sell immediately after the IPO. A model is built that shows that the decisions are based on a reputation-based mechanism in a repeated game-setting. It is also shown that young VCs may have the incentive to use underpricing in order to credibly committing themselves to establishing reputation.	Development of a model and of testable hypotheses connected to the model.
Rosetto **2008** "The price of rapid exit in venture capital-backed IPOs"	Annals of Finance	Proposes an explanation of two empirical puzzles surrounding IPOs: 1) IPO underpricing increases during "hot issue" periods. 2) venture capital-backed IPOs are less underpriced than non venture capital-backed IPOs during normal periods of activity, but the reverse is true during "hot issue" periods. Developing an empirical model, suggesting that when IPOs are driven by the initial investor's desire to exit in order to finance a new venture, the values of both the existing and new venture drive the decision of price and fraction to be sold in the existing IPO. The availability of attractive new investments increases equilibrium underpricing.	Model development.
Shepherd & Zacharakis **2001** "Speed to Initial Public Offering of VC-Backed Companies"	Entrepreneurship Theory and Practice	The article develops hypotheses regarding factors that affect a company's speed to IPO. The study shows that geographical location in the U.S. affects the speed to IPO and that companies located in the West and Midwest are exited faster than companies located in the Northeast. Industry group does not have a significant effect, except that non-high-tech companies are faster than computer companies. The relative activity of the IPO market over time increases the speed to IPO, and portfolio companies that have gone public more recently have a greater speed.	Testing five hypotheses by performing an ANOVA analysis on 906 U.S. portfolio companies that went public in the period 1984 to June 1999. The sample is drawn from a database assembled by the National Venture Capital Association.

Appendix 4 – Literature on Legality and Control

Author(s) Year Title	Journal	Purpose and Findings	Methodology
Cumming **2008** "Contracts and Exits in Venture Capital Finance"	*The Review of Financial Studies*	The author aims to study the relation between venture capital contracts and exits. Strong VC control rights are found to increase the likelihood of an acquisition. The use of common equity increases the probability of an IPO, and write-offs are less likely when specific veto and control rights are used. In conclusion, VC control rights are correlated with, and facilitate, exit outcomes.	Survey to all venture capital funds which are members of the EVCA. Follow-up interviews with the 35 funds that responded, covering 223 investments in the period 1995-2002.
Cumming, Fleming, & Schwienbacher **2006** "Legality and venture capital exits"	*Journal of Corporate Finance*	The authors want to investigate the effect of Legality on the exiting of venture capital investments. They find that Legality is of high importance for exiting private investments, and that a higher Legality index increases the likelihood of an IPO. High quality legal environments facilitate successful exit environments and active venture capital markets, which in turn are correlated with active stock markets.	Empirical study of a hand-collected dataset of 468 venture-backed investments from 12 Asia-Pacific countries comprising 53 venture capital funds.
Cumming & Johan **2008** "Preplanned exit strategies in venture capital"	*European Economic Review*	An examination of the relation between pre-planned exit vehicles and contracts and contractual rights. The researchers find that exits are pre-planned in 31 % of the cases. Preplanned acquisitions are associated with stronger veto and control rights in favor of the investor and greater use of convertible securities.	Empirical analysis of 223 firms backed by 35 European VCFs in the period 1995-2002. Information gathered by survey and interviews.
Gompers **1995** "Optimal Investment, Monitoring, and the Staging of Venture Capital"	*The Journal of Finance*	The author studies the structure of staged venture capital investments when agency and monitoring costs exist. Greater R&D intensity and higher market-to-book ratios lead to more frequent monitoring. VCs maintain the option to discontinue funding projects with little probability of going public.	Random sample of 794 VC-financed companies, financed between January 1961 and July 1992. Data collected from the Venture Economics' Venture Intelligence Database.
Hellman **2006** "IPOs, acquisitions, and the use of convertible securities in venture capital"	*Journal of Financial Economics*	The purpose of this paper is to examine how exit vehicle decisions are made, and to explain features of venture capital contracts. Convertible preferred equity gives different cash flow rights for acquisitions and IPOs. Contingent control rights are important for achieving efficient exit decisions.	Model development and analysis.
Kaplan & Strömberg **2003** "Financial Contracting Theory Meets the Real World: An Empirical Analysis of Venture Capital Contracts"	*Review of Economic Studies*	Compares the financial contracts between VCs and entrepreneurs with financial contracting theory. The results show that real-world contracts are more complex than existing theories predict. VCs are allowed to separately allocate cash flow rights, board rights, voting rights, liquidation rights and other control rights.	Empirical analysis of 123 investments in 119 ventures by 14 venture capital firms.

Sahlman **1990** "The structure and governance of venture capital organizations"	*Journal of Financial Economics*	This paper aims to describe and analyze the structure of venture capital organizations and the relationships between investors, VCs and entrepreneurial ventures. It is shown that staging of capital, compensation based on value creation and mechanisms to distribute capital and profits are used to cope with the agency problems that exist.	Model development and analysis.
Smith **2005** "The Exit Structure of Venture Capital"	*UCLA Law Review*	The author aims to analyze the exit provisions regulated by venture capital contracts. The contracts serve to lock VCs into the investment during the initial stage, but in the later stages the VCs acquire increasing control over exit.	Empirical analysis of 367 venture-backed companies.
Williams, Duncan & Ginter **2006** "Structuring deals and governance after the IPO: Entrepreneurs and venture capitalists in high tech startups"	*Business Horizons*	This paper seeks to increase the understanding of the effects of venture capital investment on selected firm governance and financing structures. The data shows that the involvement of VCs reduces the role of the founder-entrepreneur in strategic decision making. Further, VCs prefer to invest together with other VCs, and the partners share the risk and reward.	A sample of 190 publicly traded biotechnology and healthcare firms that filed an IPO registration statement in the period January 1996 to December 199 was studied.

Appendix 5 – Literature on Value-Adding Activities

Author(s) Year Title	Journal	Purpose and Findings	Methodology
Barney, Busenitz, Fiet & Moesel **1996** "New Venture Team's Assessment of Learning Assistance from Venture Capital Firms"	*Journal of Business Venturing*	The authors aim to examine the conditions that impact a venture's evaluation of nonfinancial advice. The central finding is that ventures differ in their evaluation of VC assistance. The optimal involvement of learning is contingent upon the openness to learning.	Mailed surveys to 837 new ventures that had received at least one round of financing. This yielded a final sample of 205 firms.
Busenitz, Fiet & Moesel **2004** "Reconsidering the venture capitalists' "value added" proposition: An interorganizational learning perspective"	*Journal of Business Venturing*	An examination of the interorganizational relationships between VCs and NVTs and their contribution to long-term improvement in the performance of a venture. No statistically significant support for strategic information was found. A negative association for dismissals was found. Positive support for procedurally just interventions was found.	Surveys sent to ventures that received venture capital between 1987 and 1989. Follow-up surveys were conducted in early 2000.
Dimov & Shepherd **2005** "Human capital theory and venture capital firms: exploring "home runs" and "strike outs""	*Journal of Business Venturing*	An investigation of the relationship between the education and experience of VCs and their performance. General human capital had a positive association with the proportion of portfolio companies going public, specific human capital had not. Specific human capital was negatively associated with the proportion of portfolio companies that went bankrupt.	112 U.S. venture capital funds that had invested in over 20 portfolio companies and at least one in the wireless communication industry were randomly selected and analyzed.
Ehrlich, De Noble, Moore & Weaver **1994** "After the Cash Arrives: A Comparative Study of Venture Capital and Private Investor Involvement in Entrepreneurial Firms"	*Journal of Business Venturing*	Determines how initial relationships are established and maintained between entrepreneurs and their primary investors. A VC places more stringent control on the venture, demands more frequent reporting, and is better to gain access to additional rounds of equity than private investors. Who the entrepreneur receives the funding from is as important as the amount raised.	Surveyed entrepreneurs in Southern California, U.S. 47 entrepreneurs were included in the study.
Gorman & Sahlman **1989** "What Do Venture Capitalists Do?"	*Journal of Business Venturing*	The aim is to shed light on the relationship between VCs and their portfolio companies. VCs spend about half their time monitoring nine portfolio investments, and sit on the board of five of these. The most important activity is to raise additional capital, help with strategic analysis and management recruitment. Weak senior management was considered to be the dominant cause of venture failure.	Questionnaire sent to 100 VCs in late 1984, with 49 respondents.
Macmillan, Kulow & Khoylian **1989** "Venture Capitalists' Involvement in Their Investments: Extent and Performance"	*Journal of Business Venturing*	The purpose of this paper is to identify any connection between VC involvement and venture performance. VCs were mostly involved in the financial aspects of the venture. Four distinct areas of involvement: development and operations, management selection, personnel management and financial participation. Three types of involvement: laissez faire, moderate, and close tracker.	Questionnaire to 350 VCs. 62 answered, and a regression analysis was performed.

Sapienza 1992 "When Do Venture Capitalists Add Value?"	*Journal of Business Venturing*	Examines when VCs add value. The greater the innovation pursued by the venture, the more frequent the contact between the lead investor and the CEO, the more open the communication, and the less conflict, the greater was the value of the involvement. The value of the VC's involvement was strongly positively correlated with venture performance.	Questionnaire to the entrepreneurs of 51 venture capital-backed ventures in the U.S. and the lead VC in each of these portfolio companies. Response rate of 85 % for the entrepreneurs and 80 % from the venture capitalists.
Sapienza, Manigart & Vermeir 1996 "Venture Capitalist Governance and Value Added in Four Countries"	*Journal of Business Venturing*	Examine the drivers of VC governance and value added in the U.S., the UK, France and the Netherlands. VCs view their strategic involvement as their most important role, which is providing financial and business advice. Other important contributions were to act as a mentor and to give access to their network.	The U.S. study included interviews with VCs and CEOs of portfolio companies, as well as follow-up questionnaires. The personal interviews, conducted in 1987-88, had a response rate of 85 % and 80 %, respectively. Surveys were also mailed to VCs in the U.K., France and the Netherlands.

Appendix 6 – Literature on Social Capital

Author(s) Year Title	Journal	Purpose and Findings	Methodology
Chaplinsky & Gupta-Mukherjee **2010** "The Form of Exit in Venture Capital: Implications for Reputation Building"	*Unpublished Working Paper*	The authors aim to shed light on the role of the chosen exit vehicle in resolving information asymmetry problems related to VCs' skill and reputation-building. The authors find that returns to M&A and IPO exits are systematically different, but the form of exit itself is not a perfect indicator of quality. IPOs are more valuable to the VC in terms of reputation building. Top quartile M&A returns are harder to achieve than top quartile IPO returns, but they carry a lower reputational value.	Empirical study using a sample of returns from 1,222 M&A and IPO exits from U.S. based venture capital-backed companies over 1985 to 2008.
Fisher & Pollock **2004** "Effects of Social Capital and Power on Surviving Transformational Change: The Case of Initial Public Offerings"	*The Academy of Management Journal*	The authors aim to explore how social capital and the power of VCs and founder CEOs affect the likelihood of firm survival post-IPO. They find that average management team tenure and the IPO deal's network embeddedness decreases the likelihood of firm failure during the first five years post IPO. In addition, CEO ownership and VC ownership concentration also decreases the likelihood of failure.	Empirical study using data from 218 U.S. initial public offerings conducted in 1992.
Gompers & Xuan **2009** "Bridge Building in Venture Capital-Backed Acquisitions"	*AFA 2009 San Francisco Meeting Paper*	The authors aim to explore the role that VCs play in intermediating relationships between various market participants by looking at the potential for bridge building. The results show that VCs can form a bridge between acquiring and target firms, thus reducing the asymmetric information associated with the transaction for both parties.	Empirical study of 1,261 acquisitions of U.S. venture capital-backed private companies performed between 1992 and 2006.
Hochberg, Ljungqvist & Lu **2007** "Whom You Know Matters: Venture Capital Networks and Investment Performance"	*Journal of Finance*	The authors examine the performance consequences of networks for VCs in the context of relationships established when VCs syndicate portfolio investments. The results show that better-networked VCFs experience significantly better fund performance, as measured by the proportion of investments that are successfully exited.	Empirical study of all investments by U.S. VC funds between 1980 and 1999 using graph theory.

Appendix 7 – Literature on M&A

Author(s) Year Title	Journal	Purpose and Findings	Methodology
Cartwright & Schoenberg **2006** ”Thirty Years of Mergers and Acquisitions Research: Recent Advances and Future Opportunities”	*British Journal of Management*	A brief summary of past M&A research, with focus on recent advances and suggestions for future research. Also looking at a paradox surrounding M&A; even though it has been a field of research for 30 years, the performance of M&As has not improved.	Literature review.
Capron & Shen **2007** “Acquisitions of Private Vs. Public Firms: Private Information, Target Selection, and Acquirer Returns	*Strategic Management Journal*	Testing a set of hypotheses regarding: the drivers behind the acquirer’s choice between private and public targets; the stock market reaction to acquisitions of private vs. public firms; and if the acquirers gain when their selection of a public or private firm fits the theory. The main findings are: acquirers favor private targets in familiar industries, but turn to public targets when entering a new business; acquirers of private targets perform better than acquirers of public targets on merger announcement; and that acquirers in general make the right choice when choosing between acquiring a private or public firm.	A combination of an international post-acquisition survey with 273 responses, and an event study looking at the 101 stock-listed acquirers from the survey, where public information was available.
Graebner & Eisenhardt **2004** ”The Seller’s Side of the Story: Acquisition as Courtship and Governance as Syndicate in Entrepreneurial Firms”	*Administrative Science Quartely*	The paper looks at the acquisition process from the seller’s side, and seeks to identify under which conditions firms want to sell, and which factors determine the choice of acquirer. Managers seek to sell when they meet strategic hurdles, and are driven by personal motivations as past failures and investments by friends. It is also shown that the management looks for buyers that offer a potential for synergy and organizational rapport, and that price is not always given top priority. The authors state that acquisition hence is similar to courtship, rather than to a mere takeover. Another contribution from the authors is the view of corporate governance as syndicate, where VCs and entrepreneurs make a joint decision with regards to buyer.	A multiple-case, inductive study of 12 U.S. technology-based ventures. The entrepreneurial firms are selected from three industries; networking hardware, infrastructure software, and online commerce.
Kesner, Shapiro & Sharma **1994** “Brokering Mergers: An Agency Theory Perspective on the Role of Representatives”	*The Academy of Management Journal*	The study uses an agency theory perspective to look at the relationship between investment bankers and the parts in merger deals. The hypothesis is that a conflict of interest between the bankers and the firms they represent exists, since bankers typically are compensated with a percentage of the total deal, regardless if they represent buyers or sellers. The analysis supports the hypothesis; investment bankers and targets have aligning goals, but there is a conflict of interest between the bankers and the buyers.	A quantitative analysis conducted on 77 mergers done between publicly traded companies, made in the U.S. from 1983 through 1990.

Petty, Shulman & Bygrave **1994** "Mergers and Acquisitions: A Means of Harvesting the Venture"	*Managerial Finance*	The article shows that the factors influencing the selling decision are estate planning, the opportunity to diversify, and the need for financing growth. There is a large degree of disappointment among selling entrepreneurs after the merger process, and the management often seem to have unrealistic expectations when entering the exit process. Finally, it is also suggested that entrepreneurs lack experience when it comes to negotiations and to the post-sale period.	A sample of acquisition transactions of private firms conducted between 1984 and 1990 is used to prepare an interview guide, used to conduct personal interviews with the entrepreneurs being acquired.

Paper 2

Pre-Planned Exit Strategies and Value-Adding in Venture Capital Trade Sale Exits

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Abstract

This study examines the link between pre-planned exit strategies in venture capital and the value-adding activities conducted by venture capitalists. Through an inductive, multiple-case study examining 14 Norwegian and U.S. trade sale exits, we find that two polar groups of investors exist, namely the Tailor and the Architect. The Tailor has a pre-planned exit strategy, and this affects both his investment decision and the value-adding activities he conducts post-investment, as these activities are performed with exit specifically in mind. The Architect has a more agnostic approach to pre-planned exit strategies, and he adds value in a more general manner, believing that the best exit strategy is to build a great company.

Introduction

The venture capital industry is struggling. Since the golden age of software investing from 1997 to 2000, quarterly IRRs for U.S. venture capital firms (VCFs) have declined from a staggering 83 % high to single digit percentages, even falling into negative waters for some quarters (Ghalbouni and Rouizes, 2010). A part of this problem is the combination of a lower number of deals and an increased time to exit. The number of IPOs, historically regarded as the most attractive exit route for venture capitalists (VCs) (Megginson, 2004), has seen a sharp decrease over the past years, and trade sale exits have become by far the most common exit vehicle. As a matter of fact, statistics from the National Venture Capital Association show that in the period 2004-2010, 2498 exits in the U.S. were trade sales, compared to 384 IPOs (NVCA, 2011).

Nevertheless, most research is still focused on IPO exits (Félix et al., 2008). This is in large part due to more easy access to data, and the common belief that IPO is the most prestigious exit route (Chaplinsky and Gupta-Mukherjee, 2010; Megginson, 2004). A few voices in the mid-1990s suggested that this disproportionate focus on IPO exits was skewed, and that more effort should be put into trade sale exits, both from an academic and practical point of view (Relander et al., 1994; Wall and Smith, 1997). However, with the aforementioned boom in IPOs in the late 1990s, it is perhaps not surprising that the academic community kept focusing on this area.

Given the venture capital business model, VCs are dependent on exits to generate returns. It is therefore somewhat surprising that there seems to be a lack of research in the area, especially when it comes to trade sale exits. With today's market conditions, trade sale exits are as relevant as ever, and it is with that backdrop this article departs. We will seek to open parts of the black box that is currently hiding the dynamics of a trade sale exit.

The field of pre-planned exit strategies and their link to investment decisions is an area where little previous academic work has been done. Some scholars have proposed that there are two main approaches to investing; the proactive and the reactive approach (Relander et al., 1994; Wall and Smith, 1997). Investors in the first group use a combination of traditional evaluation criteria and exit possibilities when evaluating potential deals, and will have a pre-planned exit strategy when entering an investment. The latter group is more focused on business possibilities, and will seek to identify exit possibilities as they arise through the life of the investment.

Based on a review of value-adding literature, we propose that these two groups of investors will have a different approach to value-adding. If it is true that the first group is concerned with exits from day one, we expect that this will be reflected in their value-adding post-investment, and that they will perform value-adding activities with exit specifically in mind. That is, internal activities that are conducted to tailor the company for a potential buyer, and external activities that serve the purpose of making the company known among actors that might have an interest in acquiring the portfolio company. We anticipate that the second group of investors will add value in a more general manner, and that the focus is on building a great company, rather than optimizing it to fit with the needs of potential buyers. Regardless of what approach the VC is fonder of, it will have a significant influence on how the company is configured, as well as have implications for how prepared the VC is for exit when entering the exit phase. With this background, we set out to explore:

- The different mindsets towards pre-planned exit strategies among VCs
- If there is a link between having a pre-planned exit strategy and the focus of the VC's value-adding activities

To shed light on this research agenda, we have conducted an inductive multiple-case study, where 14 Norwegian and U.S. VCs were interviewed, focusing on case-specific trade sale exits that they had been involved in. The findings from our empirical study to a large degree confirmed our expectations. Two polar groups of investors emerged, and they have been labeled the Tailor and the Architect. The Tailor is a close tracker who is extremely focused on exits, and this is reflected both in his evaluation of deals and in the value-adding activities he conducts. The Architect is more of an opportunist with a strong belief in that building a great company is the best exit strategy.

The rest of the article is structured as follows. Section II builds an initial framework that can be used to put our empirical findings into context. Section III explains the methods used to conduct the study and gives a short introduction to the cases. Section IV describes our main findings. Finally, the findings are compared to our initial framework in section V, followed by the implications of this study in section VI.

Theoretical Framework

This section will seek to build an initial theoretical framework that can help understand how VCs evaluate their investment proposals in the light of future exit opportunities and value-adding. By combining insights from deal screening literature and the value-adding domain, it will be shown why we suggest that VCs can be divided into two main classifications, namely the Tailor and the Architect*,* and it will be elaborated on the traits characterizing these two archetypes of investors.

Deal Evaluation

In the pre-investment phase (De Clercq et al., 2006), the VC is looking for business ideas offering a large market potential, protection of intellectual property, and realistic production, marketing and financial plans that can be executed within the VC's desired time frame. The entrepreneur and management team is another important factor taken into account, and an ambitious, motivated, honest, and experienced team with both general business experience and industry related expertise is preferred (De Clercq et al., 2006).

A more detailed account of the decision making process is given by Fried and Hisrich (1994). This model divides the pre-investment phase into six distinct steps; origination, VCF specific screen, generic screen, first-phase evaluation, second-phase evaluation, and closing. The VCF specific and the generic screen includes evaluation criteria as the size of the investment, the industry and geographical location of the venture, financing stage, review of the business plan, and other information available to the VC. During the first-phase evaluation, existing investors and customers, potential customers, and former business associates are contacted to gather information, and the VC and entrepreneurial team meet at one or more occasions. In the second-phase evaluation stage, focus is switched from determining interest in the deal to evaluating the potential risk factors of the deal.

MacMillan et al. (1985) take a closer look at which criteria the VCs are concerned with during the different evaluation stages. They find that the personality and experience of the management team dominate financial criteria, and that product and market criteria are regarded as less important than the former two. This emphasis on human capital is also supported by several other scholars (De Clercq et al., 2006; Guild and Bachher, 1996; Tyebjee and Bruno, 1984). However, Baum and Silverman (2004) suggest that VCs actually give too much attention to human capital when evaluating deals. Human capital as a decision criteria is somewhat downplayed by Hall and Hofer (1993), who in their study found that even though the VC made observations on the entrepreneur with regards to age, experience, and other factors, these observations did not play a major role in the decision to accept or reject the proposals. The exception was when the entrepreneurial talent was at the extreme ends, meaning very incompetent or competent.

The research on VC decision making has also been criticized (Sandberg et al., 1988). Zacharakis and Meyer (1998) propose that past research might have been somewhat misleading, and their findings suggest that:

> VCs are not good at introspecting about their own decision process. Even within the confines of a controlled experiment, which greatly reduces the amount of information considered, VCs lacked strong understanding of how they made decisions (Zacharakis and Meyer, 1998).

Regardless of what criteria the VCs actually use when evaluating deals, pre-planned exit strategies are rarely mentioned as a factor taken into account. By all means, given the venture capital business model, exits are important and can be said to be implicitly considered. But still, pre-planned exit strategies and future exit opportunities seem to be missing from the equation. The next section will therefore take a closer look at what role pre-planned exit strategies play during the screening and evaluation stages.

Pre-Planned Exit Strategies

Following the definition of Cumming and MacIntosh (2003), five different exit vehicles exist: IPO, acquisition/trade sale, secondary sale, buyback, and write-off. It is highly unlikely that a VC will have a pre-planned exit strategy based on the latter three, as these often are associated with lower returns (Cumming et al., 2006; Wall and Smith, 1997). Therefore, trade sale exits and IPO exits will in reality be the only two plausible pre-planned exit strategies.

Cumming and Johan (2008) performed a study which found that exits were pre-planned in 31 % of the cases, defining a pre-planned exit strategy as:

> … a reasonable expectation that the investor will want to dispose of the entrepreneurial investment either by IPO or acquisition (i.e., trade sale), and this expectation is formed prior to contracting with the entrepreneur. This expectation need not be revealed to the entrepreneur, and even if it is revealed, it need not be fully revealed.

Relander et al. (1994) demand more than a reasonable expectation, and suggest that a proactive investor (labeled the path sketcher) performs a thorough analysis of both business and exit possibilities before investing, that these analyses influence the investment decision, and that exit possibilities will influence the deal structure. However, the path sketcher described by

Relander et al. (1994) does not necessarily plan the exit before investing, but is aware that most successful exits are trade sales. Wall and Smith (1997) includes another dimension, namely the management. They suggest that in order to be fully proactive, the management needs to be informed of the desired exit strategy, and incentivized properly in order to align interests. This investor also takes requirements of exits into operating plans. Finally, he is able to identify potential buyers together with the entrepreneur by looking at corporations that could benefit from improvements made by the venture (Relander et al., 1994).

The reactive investor has a different approach. He trusts the management skills and the concept of the investment target and might map out some exit opportunities, but these opportunities have little influence on the investment decision (Relander et al., 1994). The portfolio companies of this investor are always for sale depending on price, but he believes that a lot of clients would not come to him if he planned the exits in advance. This investor reviews his portfolio regularly, keeping an eye open for potential buyers and identifies opportunities as they arise (Wall and Smith, 1997).

For the purpose of this article we will use a combination of the definitions above:

> An investor with a pre-planned exit strategy has a clear expectation about which exit form is most suitable, formed prior to contracting through a thorough analysis of both business and exit possibilities, and will inform management of his plans prior to investing.

It is hard to draw a determined conclusion with regards to what degree VCs are concerned with explicit exit strategies pre-investment. Although all VCs as mentioned are (and should be) implicitly concerned with exits, it seems like there are two different approaches to deal screening; the proactive and the reactive approach, and the rest of this article will use these two different approaches as a vantage point.

Value-Adding

With our two different investors fresh in mind, we move on to the value-adding domain. Baum and Silverman (2004) argue that the VC selects his particular investments based on a combined logic of "scouting" for strong technology, and "coaching" (Hellmann, 2000) via the injection of management skill, commonly known as value-adding. This suggests that when considering investment decisions, it is natural to also consider value-adding to get a better picture of VC decision making. The next section will therefore take a closer look at the link between pre-planned exit strategies and value-adding.

Although the value-adding hypothesis is disputed among scholars (Busenitz et al., 2004), the practitioners themselves are confident in their ability to enhance portfolio company performance through providing advice (Perry, 1989; Rock, 1991). A partner in a major U.S. VCF estimated that he aggregated returns of 70 percent when he took an active role, while passive investments only yielded 8 percent (Pratch, 2005). Other studies have also shown that venture capital-backed startups outperform comparable startups that are not venture capital-backed (Megginson and Weiss, 1991).

The primary responsibilities of VCs in the post-investment phase are monitoring and to conduct value-adding activities (Busenitz et al., 2004; Dimov and Shepherd, 2005; Sapienza, 1992), and they spend more than half of their time on these two activities (Gorman and Sahlman, 1989). Several studies suggest that the main value-adding activities for the VC are to assist the portfolio company in financial and strategic matters such as raising additional capital, providing strategic advice, recruiting management, and serving on the board of directors (Ehrlich et al., 1994; Gorman and Sahlman, 1989; MacMillan et al., 1989; Sapienza et al., 1996). Other contributions include acting as a mentor and to give access to their network (Sapienza et al., 1996).

Fried and Hisrich (1995) point to the importance of the value-adding activities that are dependent on the VCs network, such as helping to raise money, finding employees, finding acquisition or corporate partners, and giving access to strategic information. This emphasis on network is supported by Hochberg et al. (2007), who find that better-networked VCFs experience better fund performance, measured by the proportion of successful exits. Having a strong network enables the VC to provide higher quality value-adding services, and hence increases the probability of a successful exit.

Other network-related areas where the VC can add value are through the facilitation of strategic alliances (Lindsey, 2008), and through acting as a bridge builder between acquirer and target, reducing information asymmetry by conveying information between the two firms through his personal relationships (Gompers and Xuan, 2009). Stuart et al. (1999) propose that:

> … faced with great uncertainty about the quality of young companies, third parties rely on the prominence of the affiliates of those companies to make judgments about their quality and that young companies "endorsed" by prominent exchange partners will perform better than otherwise comparable ventures that lack prominent associates.

In conclusion, the different roles a VC can assume in his value-adding activities are summarized by De Clercq et al. (2006):

- Strategic Role: Provide advice on strategic and marketing issues, as well as organizational development (Sapienza, 1989).
- Financing Role: Arrange financing from other investors such as VCs, banks, and others (Lerner, 1994), and assist in developing internal financial management procedures.
- Networking Role: Let the entrepreneur benefit from the VCs network when looking for financing, external managers, service providers, acquisition candidates or customers.
- Interpersonal Role: Serve as a mentor, friend and confidant, and give moral support.
- Reputational Role: Lend a reputational benefit that can be help when recruiting top management, getting initial sales and attracting more investment.
- Discipline Role: Add value through evaluation, and if necessary, replacing underperforming management (Fried et al., 1998).

Now that the different areas where a VC can add value have been examined, the next section will seek to integrate the findings into an initial framework that can be used to examine our empirical findings.

Initial Framework

Previous research has not looked closer at the connection between pre-planned exit strategies and value-adding. We suggest that a link between these areas exist, and that there are two different mindsets among VCs.

When looking at the different ways in which a VC can add value to his portfolio company, it might seem difficult to link these to a proactive or reactive mindset with regards to value-adding. After all, regardless of mindset, the goal of the VC is still a profitable exit within a desired timeframe. However, the form of exit might have an influence on what activities the VC actually chooses to conduct. As an example, if the target exit route is an IPO, there are certain criteria that need to be met with regards to company structure, documentation, and revenue, and this might be determining for the scope of the value-adding activities.

Further, we propose that an investor with trade sale as the pre-planned exit strategy will be more focused on network related value-adding activities, such as facilitating strategic partnerships and keeping potential buyers updated on the progress of the company, than an investor with an agnostic approach. By conducting such activities, the VC can increase the possibility of a successful trade sale. Given his focus on tailoring the value-adding activities to suit potential buyers, this investor has been named the Tailor.

An investor with a more agnostic approach to exit strategies, where we define an agnostic approach as both the VCs with a dual strategy (aim for IPO, with trade sale as back-up) and the VCs without a pre-planned exit strategy, might focus more on building a strong company that potentially could stand alone and be publicly listed. This does not mean that network-related activities are not important to him, but he still prefers to identify opportunities as they arise. Therefore, his value-adding activities might not be as focused on future exits as the case is for the investor with a pre-planned exit strategy, but rather have a more internal focus, such as strategy, operations, and structural reorganizations. Since we propose that the focus of this investor is on building a great company, we have labeled him the Architect.

The initial characteristics of our two investor archetypes are summarized in table 1 below.

Table 1 - Initial Framework

	The Tailor	The Architect
Pre-Investment	Analysis of business and exit possibilities influence the investment decision.	Exit opportunities have little to none influence on the investment decision.
	Has a pre-planned exit strategy.	Does not have a pre-planned exit strategy.
Post-Investment	Identifies potential buyers together with management by looking at the space they operate in.	Identifies opportunities as they arise.
	Adds value with exit in mind, focusing on network related activities.	Adds value with the company in mind, and has a more general focus.

Methodology

The research design utilized in this study is a multiple-case, inductive study involving 14 venture-backed trade sale exit processes. Multiple cases allow for replication logic, where each case can be looked upon as an experiment. Inferences drawn from one experiment serves to confirm or disconfirm inferences drawn from the others (Yin, 1994). Multiple-case studies therefore allow for more generalizable and better grounded results than those of single-case studies.

Research setting

We chose venture capital trade sale exit processes as our research setting due to the lack of research on how value-adding is connected to pre-planned exit strategies. Further, trade sale exit processes are an intrinsic part of the venture capital business model. With trade sales by far being the most common exit vehicle, their success to a large part dictates the success of the venture capital industry as a whole. However, this practical significance of the process is not reflected in the current venture capital research, where trade sale exit processes are still somewhat of a black box. Taking the first steps towards opening that box was a major motivation for the chosen research setting.

The fact that little research has been done on venture capital trade sale exit processes motivated us to make this an inductive study. The VC's involvement in trade sale exits is a complex process, and poorly understood. Quantitative research strategies would not be able to offer the same insights into the process as rich, qualitative data would. Further, trade sale exits are laden with sensitive issues. An interview performed under the promise of confidentiality was viewed as the best method for gaining access to rich data.

Sampling

The cases included were based on a strategic sampling of completed trade sale exits. In total, we sampled 14 different cases. Several of the cases were identified as interesting by the researchers prior to initiating contact with the informants. As we immersed ourselves in the venture capital community, we were also introduced to several cases included in the sample by actors lending a helping hand. Given the fact that we were seeking to understand the VC involvement during the entire process, we sampled only cases in which the trade sale had been completed. As an added bonus, this reliance on retrospective data increased the efficiency of data collection, allowing for the inclusion of more cases in the study.

We sampled firms from various industries. Further, trade sales completed by both Norwegian and U.S. VCs were included in the sample. By including various industries and different geographical regions in our sample, the generalizability of our results should improve. Five of the 14 cases included in the sample are trade sales exits performed by U.S. VCs, while the remaining nine were performed by Norwegian VCs. The table below presents a brief overview of the 14 cases included in the sample.

Table 2 – Overview of Cases

Case	Industry	Acquired	Informants
Avalanche	Cable	2006	VC
Bruin	Electronics	2006	VC
Canuck	Networking hardware	2005	VC
Coyote	Electronics	2007	2 VCs
Flame	Networking hardware	1996	VC
Flyer	Software	2007	2 VCs
Hurricane	Energy	2007	VC
Lightning	Software	2010	VC
Panther	Energy	2007	VC
Ranger	Oil service	2008	VC
Sabre	Networking hardware	1999	VC
Senator	Electronics	2011	VC
Star	Telecom	2006	VC
Thrasher	Healthcare	2011	VC

The trade sales included in this study were completed between 1996 and 2011. This time period experienced very different market circumstances, from the hot market of the late 1990's to the financial crisis in the late 2000's and the depression that followed. As such, the rationale for, and the opportunities to complete, trade sale exits for VCs have varied considerably over the time period covered. While it was relatively easy to launch an IPO in the U.S. in the late 1990's, it was next to impossible in 2008. This variance allowed for controlling for the influence of market circumstances. The cost, of course, was the possibility of informants no longer remembering events accurately.

Data Sources

The study is based on several data sources: (1) qualitative data from semi-structured interviews with VCs, (2) e-mails to follow up interviews and ensure that we understood the accounts given correctly, and (3) archival data, including press clippings, company web sites and discussion forums.

We started with pilot interviews with informants who had considerable practical experience with trade sale exit processes, as well as academics with significant experience from the field of venture capital research. These interviews helped us form the interview guide. In addition, it made sure that we as interviewers were well prepared before entering into the next phase of the study.

We conducted 14 interviews with our key informants. The interviews varied in length from 30 to 70 minutes, and followed the aforementioned interview guide. The interviews followed a "courtroom" procedure, with the interviewers emphasizing the need to focus on facts and events rather than on interpretations (Eisenhardt, 1989). We always began the interviews by asking the respondents to recount the story of why they invested, followed by a short recap of what developments took place within the portfolio company until the actual exit process was initiated. Seeing that we were seeking retrospective reports, such open-ended questioning should lead to higher accuracy in our data (Lipton, 1977; Miller et al., 1997).

All of the 14 interviews were tape-recorded and transcribed verbatim, totaling 133 pages of single-spaced transcriptions. As mentioned, we followed up the interviews with e-mails asking clarifying questions on an as-needed basis. Interviews with Norwegian informants were conducted in Norwegian, and translated into English by the authors. We strived to ensure that nothing was lost in translation.

When possible, we took steps to minimize informant biases, and always held the data provided in the interviews up against the archival data collected from secondary sources, in order to ensure that we were not suffering from being fed biased information. Our informants were all highly knowledgeable and influential with regards to the exit process. Such informants are the most reliable (Seidler, 1974; Kumar et al., 1993; Huber and Power, 1985). Further, we emphasized during the interviews that we were interested in case-specific facts and events. Thus, the information provided is less likely to be subject to cognitive biases and impression management (Huber and Power, 1985; Golden, 1992; Miller et al., 1997). Finally, the trade sale exit process is highly sensitive, both on a personal level and business wise. We therefore promised confidentiality to our informants in order to further motivate for the provision of accurate data (Huber and Power, 1985; Miller et al., 1997).

Data Analysis

Based on the triangulation of data from our different sources, rich and reliable mini-cases of each of the trade sale exits could be built (Jick, 1979). Thereafter, within-case and cross-case analyses were performed. The analysis started by looking closer at each case on a stand-alone basis. In the spirit of the inductive process, this analysis allowed for the emergence of constructs and relationships, and was not guided by specific hypotheses.

Following the stand-alone analysis of all cases, cross-case analysis was performed. Replication logic allowed for the confirming and disconfirming of tentative constructs and propositions. This process was highly iterative, with the researchers stepping back and forth between data and analysis many times. Further, a significant amount of time was set aside for discussion both within the team and with external researchers in order to ensure the validity of the emergent constructs.

Finally, as the findings from the study were ready for presentation, a sanity check was performed. All informants were contacted and asked to correct any final misunderstandings, as well as to perform a citation check. In addition, they were given the chance to comment on the propositions put forward and the logic behind our argumentation, in order to ensure a close connection between our results and the world as it is perceived by the practitioners.

Limitations

This study is based on a strategic sampling of completed trade sale exit processes. As such, the results are not statistically representative. The cases included took place over a long period of time. While this helped control for market conditions, it does mean that the informants from the oldest cases may have remembered events inaccurately. Although we took steps to minimize informant biases, we cannot be sure that the information provided is how other stakeholders in the process experienced it. Bias and partial information may have affected our data. Interview data was triangulated with data from other sources in order to minimize the effect of this potential problem.

Findings

The following section will elaborate on the main findings from our study in light of our research questions. First, the different VCs' attitude towards pre-planned exit strategies will be clarified. Next, we will give more details on their approach to value-adding.

Pre-Planned Exit Strategy

As suggested earlier, an investor with a pre-planned exit strategy evaluates possible exit strategies and exit forms at time of investment, and these are just as important to him as the other, more traditional, evaluation criteria. He also has a clear idea about the exit form before investing, and makes sure the management is aligned. Our interviewees were asked to identify the pre-planned exit strategy, if they had one, and the results can be found in table 3. Two main groups emerged; the investors with a pre-planned exit strategy, and the ones with a more agnostic approach.

One of the most extreme instances of having a pre-planned exit strategy could be found in the Thrasher case. Here, exit opportunities were clearly used as an evaluation criterion when deciding to invest:

> … when we were investing in the company, we actually had reached out to several potential acquirers, and had bounced this company off of them, as well as the idea and the market. We got to know what the acquirer was thinking about … we knew they were interested in the company and the market before we invested. And within a year the acquirer came back to us and wanted to discuss potentially acquiring the company (Thrasher VC).

Other VCs were more confident that buyers will emerge if the company is successful, and identify opportunities as they go along, without having a pre-planned exit strategy. This is exemplified by the following quote:

> … we did not go out to sell the company, but we realized it would be a reasonable time to start considering that. And then we weren't the only ones thinking it out at the same time. So the people who called us were thinking that also, and it seemed like a good choice for everybody (Canuck VC).

Table 3 - Pre-Planned Exit Strategies

	Case	Statements
IPO	**Avalanche**	It was probably more from [our] side to say that we should take it to an IPO.
Trade Sale	**Bruin**	We had discussed that trade sale was the only relevant exit prior to investment … [The founders] had a burning passion for getting their technology into as many [products] as possible. And they saw that being acquired was a great way for them to achieve that.
	Coyote	I do not believe in listing a one product company. Very few of our investments go to an IPO, and we rarely believe they will.
	Flyer	There was a well established picture with both other investors and the management of what was going to happen before we invested. We were going to help build the company for a while, and then [the company] was going to be sold to an industrial buyer
	Hurricane	We always discuss exit possibilities with the management team and other owners prior to investment, and in this case it was pretty clear that it was going to be a trade sale exit.
	Ranger	The company had a single product, so trade sale was the only natural way to exit a case like this. So that was the exit strategy from the very beginning.
	Senator	We explicitly discussed the expectations for valuation, time horizon and so on prior to investment. … it's important to make sure that we're all as aligned as possible.
	Star	We had a dialogue with the company for a year before we invested. … we insisted on the fact that we were interested in investing, but that we would only do it if we followed our strategy of working towards a trade sale to a strategic partner. … We did not discuss an IPO.
	Thrasher	IPO was definitely not a target. And you know; we always assume that an IPO is not the likely exit in any investment we do.
Agnostic	**Canuck**	Exit strategy was not discussed prior to investment … if you build a company of substantial value, then you get to figure it out later. And the core mission is to build something of extraordinary value.
	Flame	I thought it would be acquired, because it struck me as more of a products company, a products sort of thing … but I don't think I ever explicitly asked [the founder]: "If somebody shows up in your office with 100 million, do you want to sell?"
	Lightning	I have a fundamental belief in that building a solid, well-performing company makes you attractive … Of course; we also made sure that potential buyers existed. … An IPO was also an attractive option for this company.
	Panther	We talked about how it might be possible to make an IPO happen, and we were running parallel processes.
	Sabre	We didn't have any thoughts with regards to this being a trade sale or IPO case.

When deciding on the most suitable exit strategy, the VCs with a pre-planned exit strategy are extremely aware of what type of company they are investing in. Among the different rationales given for not considering an IPO, revenue base and product portfolio are the two reasons most often quoted as determinants for choosing a trade sale exit strategy. The statements from the VCs also show that there is a focus on keeping management in the loop, as suggested by Wall and Smith (1997).

As can be seen from the selected quotes, having an agnostic view on pre-planned exit strategies does not imply not being concerned about exits at all, as previously suggested. There is however often a clear focus on building a great company, rather than focusing on the exit from day one. This is best exemplified by the statements from the Canuck and Lightning VCs. The other VCs did not necessarily share this attitude, but still did not have a clear picture of which exit form would be best suited for the portfolio company, or they did not have an exit discussion with the management prior to investing.

We also see that an investor with a pre-planned strategy is concerned with exit from day one. Therefore, he identifies potential buyers early in the process. He knows the space, prefers management who knows the space, and makes sure the VC and the entrepreneur has the social capital needed to identify potential buyers. This means that he will not be surprised when someone comes knocking and wants to buy the company.

Adding Value with Exit in Mind

To divide value-adding activities into "with exit in mind" and "without exit in mind" might seem ambiguous, and these two categories are not necessarily mutually exclusive. After all, all value-adding activities are performed to increase the probability of success, and will hence increase the probability of a successful exit. However, activities as hiring a CEO with IPO experience or facilitating strategic partnerships with potential buyers are value-adding activities that serve a dual purpose; adding value and facilitating a future exit, hence adding value with exit in mind. Therefore, we have divided the VCs into two main groups; the ones who had a proactive approach and added value with exit in mind, and the ones with a more reactive approach, who added value in a more general matter.

Investors with a Proactive Approach

Nine of our interviewees stated that they had added value with exit specifically in mind. From these activities a number of different categories emerged, and the different activities that were conducted are summarized in table 4.

Table 4 - Exit Focused Value-Adding

Case	Value Added with Exit in Mind
Avalanche	*Strategic Partnerships*: The way to get a good company to get bought is to get your potential buyers to know about you. So how do you do that? You make partnerships. *Hiring Key Personnel:* [The hired CEO] had actually taken a company public back in the nineties … The goal was to take the company public. He had done that once, right. And that was very powerful. *Advisory Board:* … once we had gotten four or five of these guys on, we had other very experienced executives calling us, trying to get on that advisory board. *PR and Marketing:* We had a semi-annual event, like a dinner, at one of these trade shows.
Bruin	*PR & Marketing*: We often try to get our portfolio companies to focus on the more general aspects of marketing. In this case, we hired an external PR advisor, who did a very good job.
Coyote	*Strategic Partnerships:* We were searching for a partner early on, and we went out and talked to all the major players in the business. And that was an excellent opportunity to get the potential buyers to get to know us. *Approach and Update Potential Buyers:* A large part of our exit strategy was to make sure that the potential buyers were aware of our company, and to keep them updated on the progress. *Strategy and Operations:* The strategy we chose became important for the exit. Because if you enter [this market], it determines what type of buyers that might be interested in the company.
Flyer	*Hiring Key Personnel:* One of the conditions for making the investment was that a new CEO and Chairman were brought in. That was part of the term sheet. *Strategy and Operations:* One important thing to consider is the type of company a potential buyer wants. *PR and Marketing:* We attended a trade show where the top 20 players in this space participated, and we talked to every single one of them.
Hurricane	*Hiring Key Personnel:* We spent quite some time on hiring a CFO, as we see a strong CFO as an integral part of the management team … this person has to be able to support the CEO in negotiations, make prognoses for future financing, and control all documentation. *Approach and Update Potential Buyers:* We run continuous processes with the M&A departments of all the large players in our specific industry three to four times per year, to update them on the companies in our portfolio. *PR and Marketing:* Good marketing does not only sell the products, it actually sells the company itself.

Lightning	*Structural Reorganization:* … we looked at making acquisitions to broaden the product portfolio, and we actually bought an American company. *Strategy and Operations:* … you get a higher valuation at the exit if you can show a business model with recurring revenues. So we were extremely focused on the business model. *PR and Marketing:* It was important for us to get on the big companies' radar screen … we have always been on the offensive towards analysts … so every time someone talked about cloud computing and IT monitoring, [the company] was mentioned as an up and coming star.
Panther	*Documentation and Procedures:* We did a lot of work on financial reports. This was important to get the procedures in place, but also to make it easier to show the value of the company later on. *Hiring Key Personnel:* The CEO had to be convinced that he needed a new CFO, and we were actually struggling to persuade him. *Structural Reorganization:* We acquired a local company, with the main goal of getting a larger volume. *Strategy and Operations:* We put quite some time into helping the company decide what technologies and markets they should focus on.
Star	*Strategic Partnerships:* It is hard for a small start-up to sell to large customers … so we wanted to sell through credible partners … we built a few strategic partnerships, and we felt we had to make our strategic value visible to them … and one of these partners ended up buying the company.
Thrasher	*Documentation and Procedures:* … the manufacturing process was not done properly, the IT and the patents were not done properly, so there was a lot of stuff that we actually went in and fixed for them, or got them to focus on. *Approach and Update Potential Buyers:* … one of the things that we heard when we spoke to the potential acquirers was that well, we don't like this; you guys need to fix this. And so that's what we did when we went into this company.

By comparing the value-adding activities identified in our case companies with the areas identified in the literature, it becomes clear that all the traditional areas of value-adding can be said to have been covered. The activities identified have been split into two main groups; internal and external focus. The internally focused activities are the ones that are done to change the internal configuration of the portfolio company, while the externally focused activities are more network-related. The next sections will focus on how the value-adding activities actually influenced the exit process for the different case companies.

Internal Focus

Documentation and Procedures: Both in the Panther and Thrasher case, the VCs had to change existing procedures. These actions served a dual purpose; not only did they improve day-to-day operations, but they also made it easier to build the proper documentation needed when potential buyers were enquiring later on. For Thrasher, these changes came as a direct result of contacting the potential buyers pre-investment, and the VCF had already made the plans before the investment was made.

Hiring Key Personnel: Two of the case companies listed the hiring of a new CFO as an important part of their exit strategy, namely Hurricane and Panther. For both companies, this was part of the goal of creating better financial documentation and procedures. The CFO himself might not be considered a valuable part of the company by a potential acquirer, but the results of his work will often play an important part of a future exit process. The Avalanche VC had a clear goal of IPO early on, and brought in a new CEO with IPO experience to improve the chances of making this happen.

Structural Reorganization: Lightning and Panther made one acquisition each. These acquisitions were not identified as being part of a synergistic plan, but simply to make the company more attractive for a future exit. Both companies were considering the possibility of an IPO, and wanted to broaden their product portfolios as well as to increase their revenue base in order to make an IPO more likely.

Strategy and Operations: In the Coyote and Flyer cases, the VCs were extremely aware of how their strategic and operational choices might affect the scope of potential buyers. A good example of this can be found in the following quote:

> One important thing to consider is the type of company a potential buyer wants. And when you make those strategic choices you might make yourself interesting to some buyers, but less attractive or even uninteresting to others (Flyer VC).

The scope of buyers is not the only concern VCs have with strategy, as shown in the Lightning case. By altering the business model it was possible to create recurring revenue streams, and hence increase the valuation that could be deducted from traditional valuation methods as DCF and multiples.

Common for all the internal factors identified is the focus on positioning the company for exit. Since this exit typically will happen in the short- to medium-term, this might be in conflict with the long-term goals of the company. For instance, it is easy to picture a situation where altering a business model or acquiring a competitor might be beneficial in the short run, but actually might hurt the company in the long run.

External Focus

Strategic Partnerships: Partnering is often an important part of the strategy of small start-ups, and can serve as a tool for getting access to customers and/or distribution, and other ways of increasing scalability. For four of the case companies, partnerships were also a deliberate way of getting potential acquirers to know their company, and in two of the cases, the portfolio company was actually bought by a strategic partner.

Advisory Boards: In the Avalanche case, the company assembled an advisory board where all the major CTOs from the industry were participating. Although this was initiated by the management team, it was highly encouraged by the VCs. Updating these executives through board meetings greatly reduced the information asymmetry, and created buzz around the company that ultimately helped facilitate the exit.

Approach and Update Potential Buyers: As with building strategic partnerships, activities that fall under this category help to make the portfolio company known among potential buyers. The cases show three different approaches: the Thrasher VCs approached potential buyers pre-investment, and made sure they knew what their thoughts on a future acquisition of the case company were; the Coyote VCs ran a process where potential buyers were continuously updated; the Hurricane VC proactively contacted the M&A departments of potential buyers on a quarterly basis.

PR and Marketing: Again, the focus is on the activities that were identified by the VCs as directed towards exits. This included participation on trade shows, keeping industry analysts updated on the progress of the company, and general branding. As stated by the Hurricane VC: "Good marketing does not only sell the products, it actually sells the company itself".

A common factor for the actions with external focus is that they all serve the same purpose: To make sure that potential buyers know that the company exists and to create attention around the fact that the company will be up for sale in the future.

Investors with a Reactive Approach

Five of our interviewees did not identify any value-adding activities that were conducted with exit in mind, and we have therefore categorized them as having a reactive approach to value-adding. Their attitudes to value-adding are exemplified in table 5.

The level of involvement among the VCs was different; the Canuck VC was mainly taking on a financing role (De Clercq et al., 2006), and did not implement any major changes to his portfolio company. The Flame VC did not have time to make any major changes due to a short time to exit, but had set up a list of milestones to be completed, including hiring new VPs of marketing and engineering. Finally, the Sabre VC focused on financing and staffing issues, but did not do this specifically with exit in mind. The relatively low level of involvement shown by these investors is often labeled laissez-faire involvement (MacMillan et al., 1989).

The Ranger VCs had to involve themselves in more aspects of building the company, since it was an early-phase start-up where the company basically had to be built from scratch. In the Senator case, a lot of time and effort was put into building an improved business model, with focus on go-to-market strategies and distribution strategies. However, this was not done with exit in mind, but to build a sustaining company. These two VCs were hence taking on more of a close tracker role (MacMillan et al., 1989).

Table 5 – Value-Adding Mindset

Case	Value-Adding Mindset
Canuck	We didn't do anything to change the company, we were just encouraging it along. We were basically financing it in a way.
Flame	We didn't really do anything about exit on this one, because it just happened so fast, it was unexpected.
Ranger	The entire company was being built; it started out as an entrepreneur with some drawings. So everything was built from scratch, and we took the lead role when doing that.
Sabre	So you're helping to control the burn-rate of the company, you're adding to the management team, and through that, hopefully building more value.
Senator	We were redesigning and developing the go-to-market strategy and the distribution strategy of the company. But we did not do that in order to explicitly sell the company, but rather to help it grow

We identified a focus on the internal activities that could help build the company, as suggested by our initial framework. This does not mean that external activities were not important, but the overall impression is that these were downplayed to give more attention to internal activities. It looks as if these investors did not specifically prepare the company for exit, but rather focused on building a good company that could be able to stand alone in the long-term.

Discussion

Based on our findings, the different investors have been classified in line with the criteria developed earlier, as shown in table 6. A pattern seems to emerge where the Tailor and the Architect actually exist. Out of the nine cases where a pre-planned exit strategy existed, seven VCs added value with exit in mind, suggesting support for the notion that value-adding with exit in mind is linked to having a pre-planned exit strategy. We found four cases that did not fit with our two archetypes, and have therefore created a category labeled Middle-Ground Investors, to which we will return shortly.

Table 6 - Summary of Cases

	Case	Pre-Planned Exit Strategy	Value Added With Exit in Mind
Tailors	**Avalanche**	Yes	Yes
	Bruin	Yes	Yes
	Coyote	Yes	Yes
	Flyer	Yes	Yes
	Hurricane	Yes	Yes
	Star	Yes	Yes
	Thrasher	Yes	Yes
Middle-Ground Investors	**Ranger**	Yes	No
	Senator	Yes	No
	Lightning	No	Yes
	Panther	No	Yes
Architects	**Canuck**	No	No
	Flame	No	No
	Sabre	No	No

Seven VCs have been classified as Tailors, three as Architects, while the final four have been classified as Middle-Ground Investors. This last group consists of investors who did not fall into our predefined categories, and it is not surprising that this group emerged. After all, our Tailor and Architect are archetypes. In the real world, there will be more of a continuous scale, with investors distributed along the scale. We found two different types of Middle-Ground Investors;

the ones with a pre-planned exit strategy who did not add value with exit in mind, and the ones who did not have a pre-planned exit strategy, but did add value with exit in mind. The classification of investors is summarized in the matrix below.

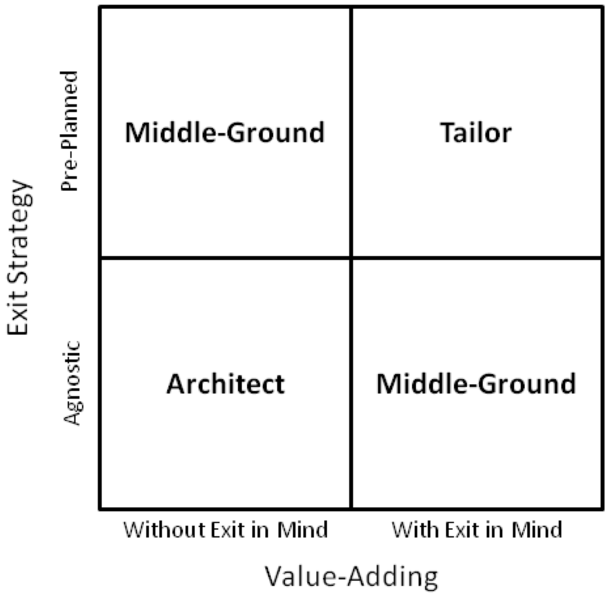

Figure 1 - Classification of Investors

Overall, the findings from our study support the suggestions we made in our initial framework. A summary of the differences between the Tailor and the Architect can be found in figure 1 below.

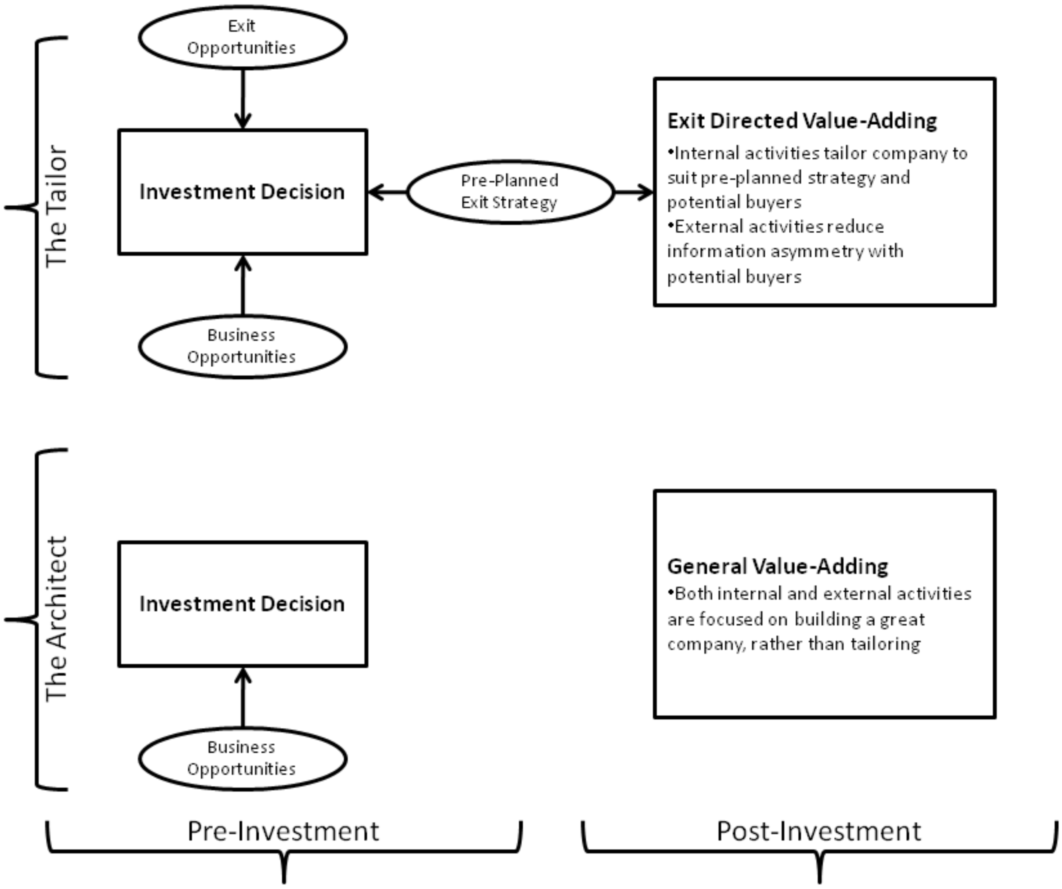

Figure 2 - Concluding Framework

The Tailor is focused on exits from day one, or even before investing, and exit opportunities is a criteria when evaluating investments on the same level as business opportunities. His pre-planned exit strategy not only influences the value-adding later on, but also the investment decision itself. We did, however, not find indications that the Tailor is focused on external activities exclusively, but found a more general pattern: The value-adding seems to be focused on internal areas where the company needs to be altered to fit with the pre-planned exit strategy, and the external activities that can help inform potential buyers about both the existence and quality of the portfolio company. There seems to be a notion that good companies do not sell themselves – the VC needs to actively take part in selling the company; not only in the exit phase, but also prior to it. Accordingly, we posit:

P1: The Tailor will through a thorough analysis of both business and exit possibilities create a pre-planned exit strategy, and inform the management of his plans, prior to investing.

P2: The Tailor will focus his value-adding on areas that will maximize the success rate of his pre-planned exit strategy.

For the Architect, the focus appears to be more directed towards building a strong company. Traditional business criteria are used to assess potential investments, and although the VC knows that an exit will happen somewhere down the line, the exit opportunities are not considered part of the evaluation criteria. When the Architect moves on to the post-investment phase, he adds value in a more general manner than the Tailor, and he is more confident that the buyers will come if the company is successful. Accordingly, we posit:

> *P3: The Architect will have an agnostic approach to exit forms and to informing management of his plans prior to investing, and believes that the best exit strategy is to build a solid company.*

> *P4: The Architect will have a general focus in his value-adding, and will not focus on activities that are directly related to exit.*

We also found that the Tailor is more of a close tracker (MacMillan et al., 1989) than the Architect, especially when it comes to spending time on exit-related activities. The Tailor divides the time spent on exit-related activities evenly through the duration of his investment, whereas the Architect becomes focused on exit when the opportunity arrives.

Conclusions and Implications

This paper set out with the goal of opening parts of the black box encasing much of the dynamics of trade sale exits. The attention was given to investigating if there is a difference in the mindset of investors when it comes to pre-planned exit strategies, and further to examining how pre-planned exit strategies influence the VCs value-adding in the post-investment phase. Through a multiple-case study covering 14 trade sale exits, we found support for our initial suspicion; that having (or not having) a pre-planned exit strategy will influence how the VC adds value in the post-investment phase.

Two archetypes of investors were identified, namely the Tailor and the Architect. The Tailor has a pre-planned exit strategy, which influences both his investment decision and his value-adding later on. His value-adding is focused on internal areas that can help tailor the company to meet the needs and requirements of potential buyers, while the external areas serve to make potential buyers aware of the company. The Architect does not have a pre-planned exit strategy, but believes that building a great company is the best exit strategy. In addition, we found a group of investors who did not fit into our two archetypes, and labeled these Middle-Ground Investors.

Implications for Practitioners

Based on the findings in this article, we will not give advice as to which approach VCs should take. However, the VC should be aware of what type of investor he is, and inform the management team of his intentions. If the VC is a Tailor, and the goal is to sell the portfolio company to acquirer X or Y in year Z, it is crucial to have management on board. Along the same lines, if the VC is an Architect and prefers to identify opportunities as they arise, the management team needs to be aware that an exit might happen unexpectedly.

Entrepreneurs should call attention to what type of VC they want. Although cherry-picking VCs might seem like a luxury most entrepreneurs cannot afford, it is important to be aware of the intentions of the VC, and make sure that there is correspondence between the entrepreneur's and the VC's ambitions. The entrepreneur should also consider what effects the VC's value-adding will have on his company; especially if the VC chooses to be extremely hands-on. Again, it all comes down to making sure alignment exists before the investment is made. This is often considered to be the responsibility of the VC, but we argue that the entrepreneur also can initiate these talks before accepting funding.

Implications for Further Research

Although this article has suggested that there are two fundamentally different approaches to investing and value-adding, we have not examined which of these two approaches that gives the best results, both in form of post-merger success for the acquirer and in terms of return for the VC. By tailoring a company to be more attractive for potential buyers, the acquirer might be able to get synergies from his acquisition faster than if he has to adapt the acquired company himself. But what if another buyer acquires the portfolio company? Building on the tailoring allegory, it would be like buying a bespoke suit that was intended for your neighbor; you might get lucky, but there is a chance you need to roll up the pant legs and invest in suspenders. And if the focus of the VC is on building a company that will generate the highest return on investment in a trade sale, it might hurt the profitability of this company in the long run. It is easy to picture a situation where a business model or a strategy is altered to get fast short-term growth, and create the illusion that the profits gained from this growth will continue in perpetuity. However, this might not always be the case. Finally, what if you build a company that no one wants to buy? In the real world, architects need to get their plans approved before their constructions are built. Our Architect, on the other hand, erects a construction and is confident that the buyers will come.

So far, we have mainly focused on the role of pre-planned exit strategies and value-adding. The descriptions of the two archetypes need to be expanded to cover other relevant areas. For instance, we observed two different attitudes among the investors with regards to selling a company versus being bought. Some investors preferred unsolicited offers, and saw them as a golden opportunity to initiate an exit process. Other investors preferred to initiate the process themselves, and felt that unsolicited offers removed focus from day-to-day operations.

More research will be needed to learn more about the VCs we have classified as Middle-Ground Investors. It might seem odd to start out with a pre-planned exit strategy, and not add value with exit in mind. However, it might be that if we were to cover more areas of the investment process, it would be easier to split this group as well.

We have also left the entrepreneur/management team of the portfolio company out of the equation. It would be interesting to further examine the relationship between the entrepreneur and the VC. Is the management team aligned with the pre-planned exit strategy, and what are their views on selective value-adding?

Trade sale exits are all about selling the company to the right buyer, regardless of how the VC chooses to attract these buyers. It could be that an Architect will need more assistance in this process, given that his focus has been on building a great company, rather than focusing on potential buyers from day one. An area that should be further examined is what role a financial advisor can play in identifying and attracting buyers, if the Tailor and the Architect have different views on the use of advisors, as well as what criteria they use to select these intermediaries.

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Paper 3

The Venture Capitalist-Entrepreneur Relationship during Trade Sale Exits

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Abstract

A profitable exit lies at the heart of venture capital. Trade sales by far dominate as the most common exit vehicle. However, this dominance is not reflected in the literature. This paper therefore seeks to take the first steps toward opening the black box that is venture capital trade sale exits. By performing a multiple-case study of 18 trade sale exits performed by Norwegian and U.S. venture capitalists, we shed light on the venture capitalist-entrepreneur relationship during the exit process. Consensus-based decision making, rather than conflict, is found to characterize the relationship. Further, we show that several factors influence the cooperative level of the relationship. These factors include the pre-investment alignment with regards to the exit, the strategic hurdles and personal motives faced by the entrepreneur, the reputation and network connectedness of the venture capitalist, and the probability for entrepreneurial recycling.

Introduction

> And this part of actually selling companies, especially at attractive terms, is what is difficult to do in this industry (Senator VC).

Entrepreneurial ventures are crucial for economic growth (Schoonhoven and Romanelli, 2001). In the current depressed market climate, innovative start-ups are perhaps more important than ever in generating wealth and employment. Venture capital firms (VCFs) provide much needed risk capital for such high-growth, entrepreneurial ventures, stimulating growth (Cumming, 2008; Shane and Cable, 2002). The success of the venture capital industry is therefore an important factor in ensuring sufficient economic growth.

The entrepreneurial companies in a venture capitalist's (VC's) portfolio are typically cash-strained growth ventures that do not pay dividends. Instead, returns are gathered as capital gains when divesting the venture (Cumming et al., 2006). As such, a profitable exit event lies at the heart of venture capital (Cumming and MacIntosh, 2003). The venture capital industry is, however, struggling with achieving satisfactory results (Ghalbouni and Rouizes, 2010).

There has been some scholarly interest in the field of venture capital exits, but most of the literature on venture capital instead focuses on the pre-investment and business development phase. Further, most studies done on venture capital exits focus on the IPO exit vehicle (Félix et al., 2008). This is understandable due to the ease of access to data for public listings versus acquisitions, and because of the prestige and exceptional returns generated by some IPO exits (Chaplinsky and Gupta-Mukherjee, 2010; Megginson, 2004). We argue, however, that this significant bias in the research towards IPO exits fails to acknowledge the extreme importance of the trade sale exit vehicle.

Trade sales by far dominate as the most common exit vehicle. Recent statistics from the National Venture Capital Association (NVCA) demonstrate that over the years 2004 to 2010, U.S. VCs exited in total 384 portfolio companies via IPO and 2498 portfolio companies via trade sales (NVCA, 2011). That is; more than six trade sale exits were performed for every IPO exit. Numbers from the European counterpart of the NVCA, the EVCA, indicate a similar dominance in the European venture capital industry (EVCA, 2010). In the literature, however, venture capital trade sale exits are still somewhat of a black box.

At the same time, entrepreneurs are often assumed to oppose trade sale exits, due to the loss of non-pecuniary benefits of control associated with an independent venture (Bascha and Walz, 2001; Brickley et al., 1994; Cumming, 2008; Cumming and Johan, 2008b; Eisenhardt, 1989a; Hellmann, 2006). VCs have been found to point to uncooperative management as one of the main reasons for failing to exit via trade sales (Wall and Smith, 1997). Simultaneously, VCs need the cooperation of the entrepreneur during the trade sale exit process in order to maximize the gains from the transaction (Martin et al., 2007). The VC's ability to unilaterally initiate the exit process is generally overstated in the literature (Smith, 2005). Conflict in the VC-entrepreneur (VC-E) relationship during the trade sale process might therefore be one factor leading to the poor performance of the venture capital industry, destroying substantial value for investors and entrepreneurs alike.

While the VC-E relationship has been the focus of considerable research (e.g. Arthurs and Busenitz, 2003; De Clercq and Sapienza, 2001; Fried and Hisrich, 1995; Shepherd and

Zacharakis, 2001; Ţurcan, 2008; Zacharakis et al., 2010), to the authors' knowledge none of these studies have focused specifically on the relationship during this phase of unwinding. Therefore, this study sets out to take the first few steps towards opening the black box that is venture capital trade sale exits, by shedding light on the VC-E relationship during the process.

Accordingly, the research questions of this study are: (1) What characterizes the VC-E relationship during trade sale exit processes? (2) Which, if any, factors influence the cooperative level of the VC-E relationship during a trade sale exit process?

Based on theoretical insights derived from the concepts of agency theory, procedural justice, acquisition as courtship and social embeddedness, we analyze empirical data from a multiple-case study of 18 venture capital trade sale exit processes performed by Norwegian and U.S. VCs. Our findings indicate that the VC-E relationship during trade sale exits is characterized more by consensus and cooperation than by conflict and defection. Further, we find that several factors influence the degree of cooperation observed. These factors include pre-investment alignment with regards to the exit, the strategic hurdles and personal motives faced by the entrepreneur, the reputation and network connectedness of the VC, and the probability for entrepreneurial recycling.

The rest of this paper is structured as follows. Section II develops the theoretical backdrop for our discussion. Section III describes the research methods used and gives a short introduction to the 18 cases covered. In section IV, the research questions are addressed in light of the empirical data gathered. Section V sums up the findings and posits propositions. Finally, we conclude and offer implications in section VI.

Theoretical Development

In this section, we seek to give a review of relevant literature analyzing the VC-E relationship in order to build a theoretical backdrop for our analysis. Agency theory, procedural justice theory and the concept of social embeddedness are theoretical vantage points in a multitude of studies, and are therefore covered in our review.

Few studies have analyzed the acquisition process from the seller's side. Typically, the focus has been that of the acquirer being the decision maker of importance. The acquire, on the other hand, is described as unimportant, unsuccessful, and reluctant (Graebner and Eisenhardt, 2004). Recently, however, a different view has been put forward. The acquisition as courtship view proposes that management of target companies are pushed towards being acquired by difficult strategic hurdles and by strong personal motivations. Similarly, they are pulled towards acquisition by attractive buyers that offer synergistic potential and organizational rapport (Graebner and Eisenhardt, 2004). In the right circumstances management may in fact take a proactive stance towards being acquired.

If the entrepreneur were to take an active role in seeking to be acquired, the posited opposition towards trade sale exits may not hold true. While this view is not developed far, it may hold new and interesting insights when analyzing the VC-E relationship during a trade sale exit process.

Agency Theory and the VC-E Relationship

In the context of venture capital, the VC is generally portrayed as the principal, contracting the entrepreneur as his agent. A conflict of interest is stipulated between the VC, who receives no private benefits of control, and the entrepreneur, who receives non-pecuniary benefits from running an independent company (Gompers, 1995). Agency theory has identified several ways for the VC to mitigate this conflict; through the allocation of cash flow and control rights via structuring financial contracts, through extensive deal screening prior to investment, and via monitoring while the project is under way (Kaplan and Stromberg, 2001).

Empirical studies have confirmed the existence of such constructs. Kaplan and Strömberg (2003) showed that an instrumental part of venture capital financings is that they allow for separately allocating cash flow rights, voting rights, liquidation rights, and other control rights. Similarly, several studies have documented the extensive pre-investment deal screening performed by VCs (e.g. De Clercq et al., 2006; Fried and Hisrich, 1994; Tyebjee and Bruno, 1984). Finally, VCs play an active role in monitoring the companies they have invested in by for example taking a seat on the board (Kaplan and Strömberg, 2003; Sahlman, 1990; Smith, 2005; Williams et al., 2006) or by staging the capital to be invested, thus making further financing contingent on reaching previously specified milestones (Gompers, 1995; Sahlman, 1990; Schwienbacher, 2005).

However, the application of the agency perspective to describe the VC-E relationship has been criticized for describing the relationship in only one direction (Shepherd and Zacharakis, 2001). By focusing on the VC's efforts to control the entrepreneur's ability to act opportunistically, it ignores the entrepreneur's concern that the VC may act opportunistically. VCs have in fact been shown to exercise opportunistic behavior in terms of shirking (Gifford, 1997), and also specifically with regards to exit decisions (Espenlaub et al., 2009; Gompers, 1996; Neus and Walz, 2005).

Arthurs and Busenitz (2003) go further in their critique, claiming that the goals of the VC and the entrepreneur are aligned during the pre-investment process. When the goals of the principal and agent are aligned, there is no agency problem (Eisenhardt, 1989a). Thus, according to Arthurs and Busenitz (2003), agency theory varies in its usefulness when it comes to explaining the behaviors of the VC and the entrepreneur during their relationship. While the agency problem is highly relevant prior to investment, it may be less relevant after the fact, as goals are aligned during the pre-investment process. However, they do allow for certain inflection points at later times during the relationship where the agency problem might reappear.

The trade sale exit process is likely to be such an inflection point. Entrepreneurs are emotionally attached to their ventures (Baron, 1998), but a trade sale exit is often linked with the departure of the entrepreneur(s) from the merged organization (Black and Gilson, 1998; Petty et al., 1999). Those who stay, have a probability of leaving the organization many times higher than the average top management turn-over rate (Hartzell et al., 2004). Being acquired means the loss of the non-pecuniary benefits previously held by the entrepreneur(s) when running a private, independent company. Therefore, it is perhaps no surprise that Petty et al. (1994) documented significant disappointment with the process and final outcome of acquisitions among several entrepreneurs.

As a result, it is often assumed that VCs will be more interested in a trade sale exit than entrepreneurs (Brickley et al., 1994; Cumming, 2008; Cumming and Johan, 2008b; Eisenhardt, 1989a; Hellmann, 2006). Whereas the VC is assumed to simply focus on maximizing the financial return from the exit, the entrepreneur(s) have several other variables that are important to them (Graebner and Eisenhardt, 2004; Hartzell et al., 2004; Petty et al., 1994).

Hence, goal incongruence during the exit process seems likely, bringing the agency problem back to high relevance. There has been supportive empirical evidence along these lines of reasoning, as Berg-Utby et al. (2007) found that the confidence in cooperative behavior in the VC-E dyad diminishes as the relationship approaches termination. VCs seek to protect themselves from the potential opportunistic behavior of the entrepreneur by implementing strong veto and control rights, especially if they expect to exit via a trade sale (Cumming, 2008; Cumming and Johan, 2008b; Hellmann, 2006). Such control rights include among others provisions such as co-sale arrangements, drag-along, anti-dilution protection, and the right to veto asset sales.

At the same time VCs point to uncooperative management as one of the main reasons for failing to exit via trade sales (Wall and Smith, 1997). Entrepreneurs may therefore be perfectly capable of stopping a trade sale exit process they are not comfortable with, even without the provision of strong legal rights. The capability of the VC to control the exit decision unilaterally may be overstated in the literature (Smith, 2005).

We therefore argue that agency theory describes real and relevant aspects of the VC-E relationship, and that it is a necessary construct in order to explain behaviors observed during the trade sale exit process. However, the literature on VC-E relationships implies that agency theory alone is not enough to understand all facets of the relationship.

Cooperation in Addition to Control

Several scholars have pointed to the concept of procedural justice as helpful in understanding aspects of the VC-E relationship (e.g. Arthurs and Busenitz, 2003; Berg-Utby et al., 2007; Busenitz et al., 2004; Cable and Shane, 1997; Fairchild, 2011; Fried and Hisrich, 1995; Shepherd and Zacharakis, 2001). The focus on self-interest and opportunistic behavior inherent in agency theory does not take into account the virtuous effects of cooperation (Ehrlich et al., 1994).

Entrepreneurs often use terms like "supportive", "open" and "friendly" to describe their relationship with their VC (Fried and Hisrich, 1995). The VC-E relationship is not characterized only by formal principal-agent relations, but also by close cooperation, where the VC hesitates to use any kind of power (Fried and Hisrich, 1995). In fact, cooperation between the managers of the VC-backed start-up and the investor has been found to be necessary for the success of the venture (Cable and Shane, 1997; Sapienza and Korsgaard, 1996; Shepherd and Zacharakis, 2001; Steier and Greenwood, 1995). In the words of MacIntosh and Cumming (2003):

> A venture capital investment is virtually by definition a relational investment, and a strong and amicable working relationship between the VC and the entrepreneur is what distinguishes a successful from an unsuccessful investment.

Many factors have been identified as determinants of cooperation, but the concept of trust holds a special position as an especially immediate antecedent (La Porta et al., 1997; Smith et al., 1995). Some initial trust may be needed to induce both parties to commit to the relationship (De

Clercq and Sapienza, 2001). Having a reputation of being honest, fair and trustworthy might provide the initial trust needed (Barney and Hansen, 1994), a point to which we will return shortly.

A survey of German VCs showed that VCs do in fact put a great deal of importance on trust in the VC-E relationship, and that there was a significant reciprocal positive relationship between trust and venture success (Duffner et al., 2009).

The trade sale exit process, with its potential for conflicting goals between the VC and the entrepreneur, should present difficulties for maintaining a relationship based on trust and cooperation. Trust and cooperation is, however, necessary in order to create as good an exit event as possible for both investor and manager (Martin et al., 2007).

Procedural justice theory holds a possible explanation to why most VCs and entrepreneurs continue to cooperate even during this time, by indicating that the reaction of individuals to the decision process tends to be more important than the decision outcome itself (Korsgaard et al., 1995; Thibaut and Walker, 1975). This perspective seems to hold also for the VC-E relationship, where entrepreneurs have been found to more willingly accept decisions, regardless of whether or not they agree with the outcome, if they found the procedure with which it was made to be fair (Sapienza and Korsgaard, 1996). More specifically with regards to exit, Busenitz et al. (2004) found that the greater the perception of procedural justice, the more likely there would be a successful exit event.

By acting fairly, and keeping the entrepreneur in the loop, the VC should therefore be able to receive cooperation from the entrepreneur even though he might not necessarily agree with the trade sale. Procedural justice theory therefore adds an important perspective when analyzing the VC-E relationship during the trade sale process.

The Social Embeddedness Perspective

Agency theory, with its assumptions of economically rational actors, seems to present an "undersocialized" (Granovetter, 1985) understanding of the complex VC-E relationship (Cable and Shane, 1997). Transactions between actors in the market of VCs and entrepreneurs, as is true for all markets, are embedded in a system of continuously evolving social relations (Granovetter, 1985). Past interaction between actors in this community can be an efficient trust-building mechanism:

> Better than the statement that someone is known to be reliable is information from a trusted informant that he has dealt with that individual and found him so. Even better is information from one's own past dealing with that person (Granovetter, 1985).

The venture capital community is closely knit, with both VCFs and entrepreneurial firms embedded in a common network structure where social relations play a crucial role (Black and Gilson, 1998; Sahlman, 1990). This is easily observable, with VCFs relying heavily on networks in their operations (Hochberg et al., 2007). Syndication of investment deals between several VCFs is commonplace in the venture capital industry (Bygrave, 1987; Bygrave, 1988; Lerner, 1994; Wright and Lockett, 2003). Similarly, VCs draw on their network of service providers when seeking to add value to their portfolio ventures (Gorman and Sahlman, 1989; Hochberg et al., 2007; Sahlman, 1990).

The highly networked structure of the VC-E community ensures that reputation effects echo loudly. Being of a less cooperative inclination therefore easily damages one's reputation, directly influencing one's ability to secure the best deals in later rounds (Black and Gilson, 1998; Cable and Shane, 1997; Sahlman, 1990; Sapienza and Korsgaard, 1996). Being known for bullying entrepreneurs into trade sale exits they do not want would quickly halt the line of quality entrepreneurs looking for investment. Similarly, the access to good deals via syndicates would likely diminish, as syndicate partners interested in keeping a good reputation would not want to risk the association with a partner they cannot trust will cooperate. In fact, syndicates are governed more by non-legal sanctions relating to effects on an actor's reputation than by contractual arrangements (Wright and Lockett, 2003).

VCs, being long term actors in the capital market, therefore have a strong incentive for maintaining an impeccable reputation in the marketplace. Hence, it should be rational for the VC to make sure that he does not utilize brute force during the trade sale exit process, but instead focuses on maintaining a good working relationship with the entrepreneur. This may be true even when it means foregoing some financial return on a specific deal, as the opportunity cost of missed future deals may outweigh the present value of increased return.

Further, acquisitions typically trigger a process of entrepreneurial recycling (Mason and Harrison, 2006; Stuart and Sorenson, 2003). Such recycling effects mean that many entrepreneurs return to start new ventures, or perhaps become business angels or VCs themselves. In other words, the acquisition event often does not mean that the entrepreneur leaves the VC-E community. The detrimental effect to the reputation of the entrepreneur from refusing to cooperate therefore is likely to be taken into consideration. As for the VC, the opportunity cost of missed future deals may act as an incentive for entrepreneurs to cooperate. Thus, the social embeddedness of exit transactions may hold explanatory insights when analyzing the VC-E relationship during a trade sale exit process.

Theoretical Insights

Hence, our review of the relevant literature paints a multifaceted picture. Agency problems seem to be relevant for trade sale exit processes, as divergent interests between the VC and the entrepreneur are likely. Control mechanisms specifically aimed at exits are therefore incorporated into term sheets. Based on the preceding discussion, control does not seem to be enough to fully understand the VC-E relationship, however.

Cooperation between the VC and the entrepreneur is instrumental for venture success. However, procedurally just decisions have a tendency to be accepted, even when all parties do not necessarily agree with the outcome. Further, the fact that the transactions between VCs and entrepreneurs are socially embedded into a tightly knit entrepreneurial community means that actors' reputation for cooperation is important. As such, contributions from the concepts of procedural justice and social embeddedness may be important when analyzing our empirical data.

Finally, the acquisition as courtship view highlights that management teams of a target in an acquisition may in fact take a proactive stance towards being acquired. If this is the case, the VC-E relationship during a trade sale exit process may be more harmonious than expected.

Based on this broad theoretical backdrop, and in light of the empirical data gathered, we address our two research questions in section IV. First, however, the following section discusses the research methods used and gives a short presentation of the cases covered.

Methodology

The research design utilized in this study is a multiple-case, inductive study involving 18 venture-backed trade sale exit processes. Multiple cases allow for replication logic, where each case can be looked upon as an experiment. Inferences drawn from one experiment serves to confirm or disconfirm inferences drawn from the others (Yin, 1994). Multiple-case studies therefore allow for more generalizable and better grounded results than those of single-case studies.

Research setting

We chose venture capital trade sale exit processes as our research setting due to the significant potential for conflict in the VC-E relationship during these processes. Entrepreneurs are typically assumed to prefer an IPO exit over a trade sale exit, while VCs might prefer a trade sale depending on the specific portfolio company (Brickley et al., 1994; Cumming, 2008; Cumming and Johan, 2008b; Eisenhardt, 1989a; Hellmann, 2006). Simultaneously, cooperation in the VC-E dyad is necessary in order to ensure maximum gains from the transaction for all parties involved (Martin et al., 2007).

Further, trade sale exit processes are an intrinsic part of the venture capital business model. With trade sales by far being the most common exit vehicle, their success to a large part dictates the success of the venture capital industry as a whole. However, this practical significance of the process is not reflected in the current venture capital research, where trade sale exit processes are still somewhat of a black box. Taking the first steps towards opening that box was a major motivation for the chosen research setting.

The fact that very little research has been done on venture capital trade sale exit processes motivated us to make this an inductive study. The VC-E relationship during a trade sale is a complex social process, and poorly understood. Quantitative research strategies would not be able to offer the same insights into the process as rich, qualitative data would. Further, trade sale exits are laden with sensitive issues. An interview performed under the promise of confidentiality was viewed as the best method for gaining access to rich data.

Sampling

The cases included were based on a strategic sampling of completed trade sale exit processes. In total, we sampled 18 different cases. Several of the cases were identified as interesting by the researchers prior to initiating contact with the informants. As we immersed ourselves in the venture capital-entrepreneur community we were also introduced to several cases included in the sample by actors lending a helping hand. Given the fact that we were seeking to understand the VC-E relationship during the entire process, we sampled only cases in which the trade sale had been completed. As an added bonus, this reliance on retrospective data increased the efficiency of data collection, allowing for the inclusion of more cases in the study.

We sampled firms from various industries. Further, trade sales completed by both Norwegian and U.S. VCs and entrepreneurs were included in the sample. By including various industries and different geographical regions in our sample, the generalizability of our results should improve. Seven of the 18 cases included in the sample are trade sales exits performed by U.S. VCs, while the remaining eleven were performed by Norwegian VCs. The table below presents a brief overview of the 18 cases included in the sample.

Table 1 - Overview of Cases

Case	Industry	Acquired	Informants
Avalanche	Cable	2006	VC
Blackhawk	Sensors	1998	CEO
Bruin	Electronics	2006	VC, CEO
Canuck	Networking hardware	2005	VC
Coyote	Electronics	2007	2 VCs, CEO
Flame	Networking hardware	1996	VC
Flyer	Software	2007	2 VCs
Hurricane	Energy	2007	VC
Islander	Oil service	2007	CEO
Lightning	Software	2010	VC
Oiler	Wireless	2006	CEO
Panther	Energy	2007	VC
Penguin	Software	2009	CEO
Ranger	Oil service	2008	VC
Sabre	Networking hardware	1999	VC
Senator	Electronics	2011	VC
Star	Telecom	2006	VC
Thrasher	Healthcare	2011	VC

The trade sales included in this study were completed between 1996 and 2011. This time period experienced very different market circumstances, from the hot market of the late 1990's to the financial crisis in the late 2000's and the depression that followed. As such, the rationale for, and the opportunities to complete, trade sale exits for VCs have varied considerably over the time period covered. While it was relatively easy to launch an IPO in the U.S. in the late 1990's, it was next to impossible in 2008. Since entrepreneurs often are assumed to prefer an IPO exit over an acquisition, this variance allowed for controlling for the influence of market circumstances. Different economic cycles did not seem to have an influence on our findings.

Ten of the cases included involved a founder-CEO. Further, eleven of the cases included were syndicated deals. We found that the same factors influenced the VC-E relationship in all cases, regardless of these two variables.

Data Sources

The study is based on several data sources: (1) qualitative data from semi-structured interviews with VCs and/or entrepreneurs, (2) e-mails to follow up interviews and ensure that we understood the accounts given correctly, and (3) archival data, including press clippings, web sites and discussion forums.

We started with pilot interviews with informants who had considerable practical experience with trade sale exit processes, as well as academics with significant experience from the field of venture capital research. These interviews helped us form the two distinct interview guides to be used in VC and entrepreneur interviews respectively. In addition, it made sure that we as interviewers were well prepared before entering the next phase of the study.

The following four months we conducted 20 interviews with our key informants. We conducted interviews with both VCs and entrepreneurs in order to ensure that we were getting both sides of the story, and to help mitigate subject biases (Golden, 1992; Miller et al., 1997). Utilizing multiple informants and seeing the picture painted by both ends of the VC-E relationship, also helps build a richer and more elaborated model (Schwenk, 1985).

The interviews varied in length from 30 to 70 minutes, and followed the aforementioned interview guides. The interviews followed a "courtroom" procedure, with the interviewers emphasizing the need to focus on facts and events rather than on interpretations (Eisenhardt, 1989b). We always began the interviews by asking the respondents to recount the story of why they invested/sought investment, followed by a short recap of what developments took place within the portfolio company up until the actual exit process was initiated. Seeing that we were seeking retrospective reports, such open-ended questioning should lead to higher accuracy in our data (Lipton, 1977; Miller et al., 1997).

All of the interviews were tape-recorded and transcribed verbatim, totaling 185 pages of single-spaced transcriptions. As mentioned, we followed up the interviews with e-mails asking clarifying questions on an as-needed basis. Interviews with Norwegian informants were conducted in Norwegian, and translated into English by the authors. We strived to ensure that nothing was lost in translation.

When possible, we took steps to minimize informant biases. We interviewed both entrepreneurs and VCs; individuals who are likely to have different perspectives and goals during the trade sale process. Thus, one would expect significant differences in their accounts of the events should retrospective bias be an issue (Seidler, 1974). We found no such difference. In addition, we always held the data provided in the interviews up against the archival data collected from secondary sources, in order to ensure that we were not suffering from being fed biased information.

Our informants were all highly knowledgeable and influential with regards to the exit process. Such informants are the most reliable (Huber and Power, 1985; Kumar et al., 1993; Seidler, 1974). Further, we emphasized during the interviews that we were interested in case-specific facts and events. Thus, the information provided is less likely to be subject to cognitive biases and impression management (Golden, 1992; Huber and Power, 1985; Miller et al., 1997). Finally, the trade sale exit process is highly sensitive, both on a personal level and business wise. We therefore promised confidentiality to our informants, in order to further motivate for the provision of accurate data (Huber and Power, 1985; Miller et al., 1997).

Data Analysis

Based on the triangulation of data from our different sources, rich and reliable mini-cases of each of the trade sale exits could be built (Jick, 1979). Thereafter, within-case and cross-case analyses were performed. The analysis started by looking closer at each case on a stand-alone basis. In the spirit of the inductive process, this analysis allowed for the emergence of constructs and relationships, and was not guided by specific hypotheses.

Following the stand-alone analysis of all cases, cross-case analysis was performed. Replication logic allowed for the confirming and disconfirming of tentative constructs and propositions. This process was highly iterative, with the researchers stepping back and forth between data and analysis many times. Further, a significant amount of time was set aside for discussion both within the team and with external researchers in order to ensure the validity of the emergent constructs.

Finally, as the findings from the study were ready for presentation, a sanity check was performed. All informants were contacted and asked to correct any final misunderstandings, as well as perform a citation check. In addition, they were given the chance to comment on the propositions put forward and the logic behind our argumentation, in order to ensure a close connection between our results and the world as it is perceived by the practitioners.

Limitations

This study is based on a strategic sampling of completed trade sale exit processes. As such, the results are not statistically representative. The cases included took place over a long period of time. While this helped control for market conditions, it does mean that the informants from the oldest cases may have remembered events inaccurately. Similarly, only two of our cases have both the VC and the entrepreneur as informants. Although we took steps to minimize informant biases, we cannot be sure that the information provided is how other stakeholders in the process experienced it. Bias and partial information may have affected our data. Interview data was triangulated with data from other sources in order to minimize the effect of this potential problem.

The Ending of a Relationship

> I like to say that this raising money and building a business is like dating and relationships. Some relationships end. Sometimes the divorce is amicable, and everybody ends up with something, and maybe they even come back together in the future. Sometimes the divorce is not amicable. I think a lot of it depends upon what the relationship is between the investors and the founders (Sabre VC).

Trade sale exit processes are typically rather lengthy. In the cases covered in this study, the actual time elapsed from the decision was made to seek a sale of the company until the deal was closed varied from a low of two months to over a year. The implication is that both entrepreneur and VC know that the relationship is drawing towards an end, and have ample time to act opportunistically during the unwinding of the relationship.

It has been claimed that there might be differing goals during this process, making agency problems likely. In fact, it has also been claimed that it would be rational for both parties to act opportunistically after the exit process has been initiated, as the importance of future transactions decrease as the exit and the ending of the relationship draws nearer (Berg-Utby et al., 2007).

Addressing research question one, we therefore looked closer at what actually characterized the VC-E relationship during the trade sale exit process in our 18 cases. What we found was more a situation of consensus-driven decision making than the image of conflict and the use of power. One might argue that since all cases covered were completed trade sales, some sort of agreement must have emerged. However, as discussed, VCs often include special legal rights in contracts that entail the possibility to force a sale. Similarly, it is possible to put the exit decision up to a formal vote in the board of directors. Such situations were not found in any of the cases covered. It is the image of a peaceful ending to the relationship which is the dominant picture in our findings from the breakup of 18 VC-E relationships. Supporting empirical data can be found in Appendix 1.

Some of the exit processes were actually truly harmonious. In the Coyote case, for example, the CEO was very interested in selling the company to the acquirer: "I did not feel like the VCs were pushing for an exit. In fact, from where I was sitting, it almost felt like I was the major driving force." Simultaneously, the investors were the ones who had suggested testing the market for a potential acquisition offer, and were very much in favor of moving the process forward as indicative bids were received.

This is not to say that there were no conflicts. In several of the cases, discussion and different views being uttered was a prevalent part of the process. While all actors held the same interests in the Coyote case, management, lead VC, and other investors often had different views on what was the desired path forward in others.

The Senator case acts as a good illustration of this situation. The portfolio company in this case had been funded by a seed investor prior to the VC investing. As the VC entered the relationship, the plan was to build substantial revenue growth by launching several of the company's products in international markets. While the product development side of the business performed well, the marketing and sales side underperformed. Selling through its own distribution channels did not perform in line with the expectations, with a substantial revenue shortfall as the result. Seeking a solution, the company increased its focus on signing deals with strategic go-to-market partners.

This process of seeking go-to-market partners exposed the company and its line of products to many potential acquirers. Seeing the potential offered by the technology developed, several of these potential partners indicated that they were interested, but that they would prefer to acquire the company rather than being a non-exclusive marketing partner. Thus, an exit opportunity arose that was not sought after, and earlier than any of the stakeholders had planned for. Deciding whether or not to act on this opportunity was a difficult discussion. The Senator VC explains:

> This exit process was very difficult. The exit opportunity arose significantly earlier than what had been the plan. So the cost price of the equity holders – the founders, the seed investor and ourselves – was significantly different. Therefore, the time horizons and the returns generated on the capital injected were very different. So this was definitely not a process where everybody agreed all the time. Instead, we developed two separate plans for what the future of the company could be. The different stakeholders preferred different alternatives – although it actually varied which one they preferred.

In other words, the Senator exit process started out with three stakeholders, all with different motivations, and with a substantially different financial result from the exit opportunity. One might very well expect that such a process would be ripe with major conflicts, and potentially end up with the most powerful stakeholder forcing through his point of view. That was not the end result, however: "In the end, it was an all agreed to solution to proceed with the trade sale" (Senator VC).

As mentioned, such discussion, and in the end, consensus-based decision making was the result in all the cases covered where some difference of opinion, and even outright conflict, was prevalent. Our data therefore left us with the clear impression that trade sale exit processes, though not in any way void of conflict, are characterized more by cooperation and interdependence than on formal power and opportunistic behavior.

Further, addressing research question number two, our analysis showed that there are several different factors influencing whether the process could best be described as harmonious or as a conflicted consensus. In the following parts we will document the influence of the pre-investment alignment of interests, the strategic hurdles and personal motives faced by the entrepreneur, and the social embeddedness of the trade sale exit process.

The Alignment of Interests

As discussed, prior literature often holds that entrepreneurs will oppose trade sale exits (Brickley et al., 1994; Cumming, 2008; Eisenhardt, 1989a; Hellmann, 2006). However, our informants often described a situation where both entrepreneur and VC held a similar interest in achieving a trade sale exit pre-investment. Such goal congruence was not expected, due to the loss of non-pecuniary benefits experienced by entrepreneurs as their private, independent companies are merged into larger organizations. What emerged, however, was that investors in most cases made a point of emphasizing their need for an exit during the pre-investment process, making sure that there was an alignment of interests.

The most extreme example of focus on alignment of goals prior to investment came from the Star case. The eventual portfolio company approached the VCF looking for investment, and was met with great interest from the VCs who recognized the potential for success. However, the founding team, consisting of two entrepreneurs, had a different view of the future and where the company should be heading strategically. Faced with differing views of the correct path to take, the VCF hesitated to invest: "… we insisted on the fact that we were interested in investing, but that we would only do it if we followed our strategy of working towards a trade sale to a strategic partner" (Star VC). This dialogue continued for more than a year, but the VC would not invest unless the founders aligned their interests with those of the potential investors: "In the end, one of the founders actually withdrew from the company because he didn't agree, but that meant that our strategy was anchored incredibly well with the founder that remained" (Star VC).

As such, the VC in the Star case made sure that there was sufficient goal congruence between the entrepreneur and investor prior to entering into the relationship. Such goal congruence has been found to lead to cooperative behavior (Apfelbaum, 1974). In fact, if the principal and agent have the same goals and interests, there exists no agency problem (Eisenhardt, 1989a). Our finding that many of the VCs emphasized building aligned interests around a trade sale prior to investing therefore seems to give some merit to Arthurs and Busenitz' (2003) claim that agency problems are taken care of pre-investment.

As shown in the table below, in ten of our cases the investors had a pre-planned trade sale exit strategy (Cumming and Johan, 2008b). While it may not be surprising that our sample involves many cases where the strategy was to exit via trade sale from the very beginning, it does nuance the picture with regard to VCs' preferred exit vehicle. The IPO exit is what is usually looked upon as the home run and as the obvious goal for VCs when investing (Bascha and Walz, 2001; De Clercq et al., 2006; Dimov and Shepherd, 2005). However, many of our investor informants emphasized the fact that it is easy to determine for many potential investment targets that they are highly unlikely to go to IPO.

Table 2 - The Alignment of Interests

Case	Do You Want What I Want?
Avalanche	**VC:** "The founders didn't have the ego need. In other words, they were looking to get a good financial return, and to build a good company. It was probably more from [our] side to say that we should take it to an IPO."
Bruin	**VC:** "We had discussed that trade sale was the only relevant exit prior to investment."
Canuck	**VC:** "Exit strategy was not discussed prior to investment. In the back of the investors' minds, it was always the case that this was more likely to be an acquisition than an IPO."
Coyote	**VC1:** "We quickly decided that this would have to be a trade sale exit. So we made sure that the management was well incentivized to want to take part in such a process." **VC2:** "We always discuss what the potential exit possibilities are prior to investment. In this case, with this being a one-product company, trade sale was the obvious vehicle. So we made sure that everybody saw that as the goal. It's important, because the issue of exit strategy can be quite the sensitive topic."
Flame	**VC:** "I had to decide what I thought [the entrepreneur] wanted before I gave him money. If I saw that he was trying to build a family business, that he wanted his kids to go to work there, and he wanted this to go on forever, that he had an unrealistic expectation of his own capabilities, I wouldn't have invested."

Flyer	**VC1:** "There was a well established picture with both other investors and the management of what was going to happen before we invested. We were going to help build the company for a while, and then [the company] was going to be sold to an industrial buyer." **VC2:** "It was already decided before we invested that it was going to be a trade sale. The type of actor who was likely to be the acquirer was identified, and our ambition of exiting within a three to five year time period was known. So that was our stated intention from the point of investment, and we made sure that all stakeholders agreed."
Hurricane	**VC:** "We always discuss exit possibilities with the management team and other owners prior to investment, and in this case it was pretty clear that it was going to be a trade sale exit. When you're operating a closed fund you have to know that all actors enter into the relationship with the right motivation."
Lightning	**VC:** "There's a lot of talk about these exits. I have a fundamental belief in that building a solid, well-performing company makes you attractive … Of course; we also made sure that potential buyers existed. So it wasn't a big issue. An IPO was also an attractive option for this company. When it comes to the management, they were intelligent people. They understood that since we were operating a fund with a defined life time, we had to exit at some point."
Panther	**VC:** "We discussed exit possibilities prior to investment with the management team. It is an important part of the investment decision process. In this case, trade sale was the most likely alternative, but we didn't discard the IPO opportunity."
Ranger	**VC:** "The company had a single product, so trade sale was the only natural way to exit a case like this. So that was the exit strategy from the very beginning."
Sabre	**VC:** "We didn't have any thoughts with regards to this being a trade sale or IPO case. Seed and early stage investing is a bit like investing in a field of dreams. You're hoping that the one's that do work out have very large exits, but to try and predict it is very difficult."
Senator	**VC:** "We explicitly discussed the expectations for valuation, time horizon and so on prior to investment. To the degree that it is possible, we strive to make sure that management and investors have aligned interests. It's not possible to achieve 100 % alignment, but it's important to make sure that we're as aligned as possible."
Star	**VC:** "We always discuss exit possibilities prior to investment. And in this case it was a very tough discussion, because the founders had a very different view of the opportunities and exit perspective."
Thrasher	**VC:** "IPO was definitely not a target. … And the founders were on board with that."

Trade sale exits, although associated with less prestige and reputation building (Chaplinsky and Gupta-Mukherjee, 2010), can be just as, or even more, profitable than IPO exits (Cumming and Johan, 2008a). It is therefore only reasonable that many VCs invest in portfolio companies with the intention of exiting via trade sale. Realizing that some entrepreneurs might not be interested in selling their company to another entity, many of our informants therefore emphasized that it was very important to ensure that interests were aligned prior to investment. One of the Flyer VCs put it like this: "The first thing that we have to agree on is that the entrepreneurs want the same thing as we do. Because if they don't, we're not on the same page, and there probably won't be an investment."

Other than simply emphasizing the need for an exit, drag-along rights were found to be used by investors in order to make sure that goals were aligned prior to investment. The Hurricane VC offered some interesting comments on why his firm insisted on implementing such rights in all investment term sheets:

> Drag rights are effective in smoking out those entrepreneurs who are in it to build a lasting empire that they want to hand over to their son and then their grandson. If they sign a term sheet including such rights, their motivations are revealed to be more aligned with ours. But it has happened that entrepreneurs have said: 'Oh, wait, what if it isn't a good time for me to sell? Can't I just build a going concern that pays dividends instead?' So having that discussion around exit rights becomes a self-selection mechanism.

Thus, drag-along rights were put in place in order to make sure that the entrepreneur would be willing to participate in a trade sale should that be the resultant exit vehicle. However, the Hurricane VC also stated that such rights were not put in place with the intention of actually having to use them: "The main intention behind the inclusion of drag rights in the term sheets is not that we actually are going to force anyone to sell. We have never done so, so far."

Since such control rights were utilized in order to smoke out entrepreneurs more interested in building a lasting enterprise, it can be expected that focusing on such rights might indeed further make sure that goals are aligned prior to investment. This rationale behind the use of strong control rights also holds a possible explanation to why they have been shown to be associated with trade sale exits (Cumming, 2008).

These findings seem to indicate that interests in fact are aligned prior to investment, effectively ending the potential for agency problems. However, we also documented several cases where such discussions were not part of the pre-investment process. Similarly, while the investor might have believed that a trade sale exit was the most likely result, this was not always shared with the entrepreneur, leaving significant potential for differing expectations with regards to what the exit event would look like. Further, as is shown, there were cases where the investor had not generated a clear expectation of what the exit vehicle would be, nor spent significant effort on the issue of exiting prior to investment. Thus, while we found some support for Arthurs and Busenitz' claim (2003) of goal congruency prior to investment, it was in no way an accurate description of all our cases.

Following the logic of agency theory, goal congruence and the alignment of interests might therefore be part of the explanation why we observed consensus-driven decision making during the exit process. Our argument is supported by the fact that exit agreement prior to the process being initiated has been found to significantly increase the confidence in cooperation in the VC-E relationship (Berg-Utby et al., 2007).

The Fairness of the Exit

As shown, however, not all of the VCs interviewed emphasized the alignment of interests pre-investment. Procedural justice theory might lend a helping hand in understanding why these relationships did not degenerate into one of opposing views and conflict. According to this view, when the VC emphasizes that his business model relies on the exit event prior to the investment, it might be easier for the entrepreneur to accept the exit process as it arrives, regardless of whether or not the VC and entrepreneur have the same goals and interests. The Panther VC made a point of the importance of maintaining an open process and good dialogue with the entrepreneurs:

> We run a very open process, making sure that everybody is well informed, perhaps even to an excessive degree. It's because nobody should be able to claim that they weren't informed, or that they didn't understand or didn't know.

Based on the notion that entrepreneurs seeking funding know that an exit process is a necessary implication when inviting along VCs, it might be deemed fair when the VC asks for cooperation a few years down the line. Further, we argue that this is especially true when it is apparent to all actors involved in the venture that it is not capable of becoming an IPO candidate, as the trade sale exit is the only relevant option left.

This realization of the entrepreneurs of what it would mean to bring along venture capital was also emphasized by all five entrepreneur informants interviewed. They all clearly stated that they knew what the VC's business model was like, and that they realized prior to seeking/receiving venture capital that inviting such investors to help fund the venture meant that there would have to be an exit event some years down the road. Supporting empirical evidence can be found in Appendix 2.

Entrepreneurs might therefore be willing to accept the trade sale exit process even when they don't necessarily like it, because they realize that it is part of the cost of acquiring venture capital. Especially when dealing with investors who value the importance of having an open process around what their expectations are and where they see the venture going, the appreciation of such procedural justice from the entrepreneur's point of view is likely to be prevalent. The Penguin CEO emphasized the importance of knowing that the exit event would arrive:

> The relationship between us and the VCs was fine. We knew very well that in the end it would be the calculator that would be the determinant factor for the VC, and we entered into that relationship with open eyes.

Thus, the perceived fairness of the exit decision and process might be another important part of understanding why the conflict level documented in our exit processes was not higher. The entrepreneurs had realized this hidden cost of venture capital. This argument is supported by the finding that the greater the perception of procedural justice, the more likely there will be a favorable venture exit (Busenitz et al., 2004).

However, an important point to raise here is that these entrepreneurs did not have their dreams shattered by being acquired. In fact, the entrepreneurs in the Blackhawk and Oiler cases, for example, made a point of the fact that they were highly motivated to sell. In these cases, the cooperative basis of the relationship clearly was not based on the aligned goals of the VC and entrepreneur around the need for VC exit prior to investment, nor was it the result of the entrepreneur accepting the decision since it was deemed to be fair. Instead, as further discussed below, the entrepreneurs took a proactive approach towards being acquired – they *wanted* their company to be sold to the acquiring entity.

Strategic Hurdles, Personal Motives, and the Motivation to Sell

What we found was that in the cases where the entrepreneur faced difficult strategic hurdles and/or significant personal motivations to sell, this affected their attitude going into the trade sale exit process. In line with the acquisition as courtship view put forward by Graebner and Eisenhardt (2004), we therefore argue that these factors influence the behaviors of the entrepreneur during the trade sale exit process.

The Canuck case offers a striking example of a situation where the management team took a leading role in pursuing the sale of the company. In response to a rapid increase in the demand for their product, the company was faced with a significant sales ramp-up hurdle. The organization did not have sufficient manufacturing capacity, and was worried that quality might drop if they were to expand too quickly. Further, the increase in demand was mainly due to one major customer, and the management team worried that if the customer's customers did not end up buying the service offering in the numbers projected, the company might suddenly be stuck with capacity for which there was no demand. Other players in the industry faced similar worries, and it therefore was:

> … a natural evolution for one of them to call us, and offer us manufacturing capacity. I think that was the reason it became a logical step, both for us and for the acquirer, to take advantage of the single point of sale, and the manufacturing capacity that we knew we were starting to have trouble keeping up with (Canuck VC).

Simultaneously, the founders had a strong personal motive from selling in terms of gaining access to significant wealth that had been locked up in the venture for a while: "This was an opportunity that they [the founders] saw to take considerable wealth out of the business in an acquisition" (Canuck VC).

In the acquisition process that followed, the VC did not play a significant role:

> So it was basically the management team of [the company] that was running this process, and we were sitting in the back room saying: 'Ok, if it's a good enough offer, we'll go for it, but we don't have any rush' (Canuck VC).

Interestingly, in this case the issue of exit strategy was not discussed prior to investment, so goal congruency or procedural justice theory cannot explain the proactive stance taken by the founders. Instead, we argue that it was the substantial strategic hurdles faced by management, in combination with the personal motivation of gaining access to significant liquidity, that lead to the harmonious exit process observed. The table below lists the strategic hurdles and personal motivations documented for each case, with supporting empirical data.

Table 3 - Strategic Hurdles and Personal Motivations

Case	Strategic Hurdles and Personal Motivations
Avalanche	**Funding round:** "Either we're going to have to raise 20 million dollars, or 25 million, and keep growing to be much bigger. Or we can respond to the inbound interest." (VC) **Sales ramp-up:** "You have proven that it works, you have the promise of selling a lot of them, but you haven't had the sales force to do it yet. Now you have to scale this." (VC) **Liquidity:** Founders owned significant share of company.
Blackhawk	**Liquidity:** Significant shareholdings for all employees and founder. Wanted access to liquidity. Founder (main shareholder) was already retired.
Bruin	**External market movement:** "If [major customer] had bought a competitor of ours, we would have been done for. Because we couldn't compete against them and their eco-system. So, we thought that we either need to be acquired, or we have to do something completely different." (CEO) **Funding round:** "We could either try to take the company to the next level – but that would require substantial amounts of capital. Or, we could try to sell it." (VC) **Personal stress:** "You take a look at your cash flow statement, and you realize that you are running out of money. At the same time, you're responsible for the well-being of your employees, your wife and your child. At that point, it's all about securing funding, and an acquisition was one possible solution." (CEO)
Canuck	**Sales ramp-up:** "We were limited by how fast we could build them. And we were starting to get complaints from [major customer] that we couldn't build them fast enough. We were worried about how much capacity we could build." (VC) **Strategic gap:** Sales were very dependent on the success of a major customer. **Liquidity:** Founders saw acquisition as a way to access considerable wealth.
Coyote	**Sales ramp-up:** Major contract meant company was moving from a few beta customers to mass production. **Strategic gap:** In order to move from initial market into other verticals, a substantial distribution network needed to be built. The organization would have to grow substantially, and implement many new systems. **Funding round:** "We had basically burned through the capital that was available from the investors. And we would have needed more." (CEO)
Flame	**Sales ramp-up:** Company had one customer. Needed to expand customer base significantly. **Management search:** "We hadn't hired the VP of Marketing or the VP of Engineering. We had a lot to accomplish to turn this into a real company." (VC) **External market movement:** "The fact that the biggest, strongest player is knocking on our door, the most attractive acquirer out there, is something we have to consider very seriously. Because there are a lot of bad outcomes. I suspect that if we say no to [the acquirer], they're going to buy someone else – significantly changing the competitive framework." (VC) **Liquidity:** Founder was major shareholder. Realized significant value when selling.
Flyer	**Funding round:** "We had a strong syndicate of investors who were willing to fund the company to the next level." (VC)
Hurricane	**Funding round:** "We have limited amounts of capital, so the question was: how much will we increase the value of the company by funding it to the next level?" (VC) **Liquidity:** Founders and management positively inclined towards trade sale process since significant wealth could be realized.
Islander	**Sales ramp-up:** "We were struggling with growing pains, and saw that being acquired might help solve that." (CEO)

Lightning	**Liquidity:** "The acquirer made us an, what's the term from the Godfather, 'an offer you can't refuse'. It reflected what we and the management team saw as the potential value of the company, so it was easy to agree that selling was the right thing to do." (VC)
Oiler	**Strategic gap:** Company had large organizations both as suppliers and customers and would benefit from being part of a big company themselves. "And so we felt like, strategically, we could be a bigger, stronger business, and accomplish more, if we were part of a bigger company." (CEO)
Panther	**None.**
Penguin	**Personal stress:** The venture capital fund that had invested in the portfolio company was coming to an end, and the entrepreneurs did not like the prospect of a host of minority shareholders. Therefore, they saw acquisition as the best solution.
Ranger	**Funding round: "**So far we had built the company with seed money. The question was whether we should try to raise more funding from other actors, and bring it to the next level, or sell it now." (VC) **Strategic gap:** The company struggled with hiring well qualified personnel at a reasonable cost, hindering growth.
Sabre	**Liquidity:** "… I think in the end, given the price that was put out there, and people started doing the calculations in their head of how much money they were going to make, everybody walked away pretty pleased at how it ended." (VC)
Senator	**Strategic gap:** Company realized that it would have to build a substantial distribution network, internally or via partners, in order to scale sales. **Funding round:** Company needed new funding in order to develop market channels.
Star	**Sales ramp-up:** "The company was starting to get real sales. It was accelerating quickly." (VC) **Funding round:** "If we were going to scale the business, it would require significant funding." (VC) **Liquidity:** "The entire team was well incentivized via ownership stakes to accept the exit process." (VC)
Thrasher	**Sales ramp-up:** "We would have had to put in a lot more money to commercialize the product, and to really boost sales. And, there's always an element of the risk of execution." (VC) **Funding round:** Company needed more funding when moving into commercialization phase, but had strong syndicate of investors willing to fund it further. **Liquidity:** "So the management team was well incentivized to make sure that the acquisition happened. They were absolutely happy with their piece of the pie." (VC)

The Bruin case and the Oiler case also involved entrepreneurs motivated to be acquired. In the Bruin case, the entrepreneur felt the pressure of running out of funding. Simultaneously, external market movements were making it clear that the competitive landscape was about to change. In sum, these developments made the entrepreneur realize that it was a good time to look closer at being acquired. Similarly, the entrepreneur in the Oiler case realized the strategic benefits of being part of a bigger organization, and therefore responded positively to the trade sale exit process.

Our findings therefore indicate that there might be a sound rationale for VCs to aim for the divestiture of their portfolio companies as they approach major strategic hurdles; namely that of entrepreneurial cooperation. Similarly, personal benefits for the entrepreneur, such as significant wealth or the reduction of stress, seems to influence the VC-E relationship during a trade sale exit process.

At the other end of the scale, we identified no strategic hurdles or strong personal motives in the Panther case. Nevertheless, the Panther exit process was of a cooperative nature, with no significant conflicts. Thus, while we argue that the acquisition as courtship view is relevant, it alone is not enough to analyze the VC-E relationship during trade sale exit processes.

The Social Embeddedness of Exit Transactions

VCs are usually assumed to look upon the financial return of an exit as the dominant factor, and therefore posited to simply choose the highest bidder in a trade sale exit. What we found, however, was that given the luxury of choice, both entrepreneurs and VCs often value many other variables when choosing the acquirer of a given organization, including the issues of human and strategic fit between the two entities. Surprisingly, some of the informants also emphasized the importance of creating a virtuous result for all actors involved in the trade sale, including the acquirer, denoted as a win-win-win focus in the table below.

Table 4 - Show Me the Money

Case	Show Me the Money?
Avalanche	**Win-win-win.** Important for VC that the acquisition was a good outcome for investors, founding team and acquirer. "I am very happy with the transaction. It was a good outcome for the investors, good outcome for the team, and a good outcome for the acquirer. Which is also important." (VC)
Blackhawk	**Strategic fit.** "My company had two separate divisions. And I didn't want a potential acquirer to break the company up. So all of the potential acquirers were companies where I could make an argument that both sides fit under their umbrella." (CEO)
Bruin	**Strategic fit.** Important that the company could continue aspiring towards their goals. "Being acquired by [company] was a great way to get their technology out there. That was what was important for the founders." (VC) "We planned for world domination, and they could help us get there." (CEO) **Human fit.** "There was great chemistry between the companies. A lot of love. Now, had it been all love and no cash it wouldn't have worked out. But the fact that we could believe in what they were doing was important. And I believe the VCs agreed that it was important. So we quickly made it an exclusive process." (CEO) **Win-win-win.** Important for the VC that the trade sale ended up being a good acquisition for the acquirer, team and investors.
Canuck	**Price of greatest importance.**
Coyote	**Price of greatest importance.**
Flame	**Price of greatest importance.**
Flyer	**Human/strategic fit.** Entertained trade sale process with acquirer because of great fit. "This was the acquirer everybody wanted, but I don't think the management team even dared dream about." (VC)
Hurricane	**Win-win-win.** Important that all parties benefit from transaction.

Islander	**Human fit.** "It was very important to me that the employees landed in a structure which would maintain what we had built. So I actually blocked a sale to another, global actor, because I did not believe in their philosophy." (CEO)
Lightning	**Human fit.** "You know, if it hadn't been for the CEO, we wouldn't have landed such a solid deal. He was the driving force behind the deal, and initiated the contact" (VC).
Oiler	**Strategic fit.** An important part of choosing the acquirer was the strategic fit between the visions of the future. **Human fit.** "We also thought through what was going to be the best landing zone for our employees, to continue having interesting, fruitful careers." (CEO)
Panther	**Human fit.** Trade sale process directed at one acquirer due to connections between founders and acquirer. "Management wanted to sell to [acquirer] to keep ownership local, and because they had personal connections with the acquirer. For us it was mainly about price, but we care about keeping all parties happy." (VC) **Win-win-win.** Important that all parties benefit from transaction.
Penguin	**Strategic fit.** Management was active in directing the sale towards an actor who would build on the current organization.
Ranger	**Price of greatest importance.**
Sabre	**Price of greatest importance.**
Senator	**Human fit.** "Human fit is very important. Do the founders and other employees want to be part of the acquirer, and can the acquirer see himself working with the incumbent team?" (VC) **Win-win-win.** "It's important that it's the right solution for everybody involved. In other words, that the acquisition ends up being a success story for the acquirer." (VC)
Star	**Price of greatest importance.**
Thrasher	**Price of greatest importance.**

An example of including other factors than simply price comes from the Penguin case:

> There were some other actors interested, who wanted to acquire us. And they may have been willing to acquire us at a higher valuation. But we feared that they would simply take the code we had written, and then shut us down. So we made it pretty clear that we would work harder on making an acquisition happen if we instead focused on [the acquirer]. And we felt that the VCs listened to our concerns (Penguin CEO).

But why would VCs allow for other variables influencing the decision than those affecting their financial return? Similar findings in earlier studies have been attributed to a governance as syndicate view in which:

> … governance is an interdependent partnership between the board and executives in which each contribute unique and valuable resources in the pursuit of collective success and in the context of multidimensional motives (Graebner and Eisenhardt, 2004).

The intriguing issue of why investors and board managers would act in such a way is suggested to come from personal as well as altruistic motives (Graebner and Eisenhardt, 2004).

Our data points to the social embeddedness of transactions in the venture capital community (Black and Gilson, 1998; Granovetter, 1985; Sahlman, 1990) as the main explanation. A reputation for taking care of the founder's concerns is important for VCs in order to attract the best entrepreneurs as they seek funding: "And by the way – reputation is all you have in the venture business, and if you get a reputation for beating up entrepreneurs, guess what, not a lot of them show up on your doorstep" (Sabre VC). Further, a favorable reputation will also enhance a VCF's ability to attract investors and a host of service providers, such as lawyers, investment bankers, and auditors, who might play an important role in providing value-adding services to portfolio companies (MacIntosh and Cumming, 2003). In fact, well-connected VCFs have been shown to perform significantly better than those who are less so (Hochberg et al., 2007).

Several of our informants confirmed the value of a strong reputation with regards to attracting investors and star entrepreneurs. One of the Coyote VCs commented:

> It's been really important for us as a venture capital firm that this exit process ended up being great. It's been important for us in terms of attracting new investors, but also in terms of attracting potential deals. Everybody wants to work with people who are successful.

The Panther VC brought forward an especially interesting reason for why VCs might have a high focus on maintaining a strong relationship with their entrepreneurs during the exit process:

> It's important for us to maintain a good relationship with the entrepreneurs even after the exit. It's important because they might become serial entrepreneurs, but it's also important in terms of raising new capital for our venture capital funds, because our investors typically interview entrepreneurs from our previous portfolio companies before investing. And they actually spend quite a lot of time on it.

With VCs being long term actors in the entrepreneurial community it therefore is rational for them take into account softer values than just the financial return from the deal. As a result, entrepreneurial concerns and objections are listened to and rated as important in the discussions that arise during a trade sale exit process. Such reputational effects and the loud echoing of bad behavior (Cable and Shane, 1997) create a strong incentive for VCs to avert the myopic goal of maximizing the value of any given exit process, and instead focus on long-term results. In the words of one of our informants: "Reputation over return every time. Because life is a multi-round game" (Avalanche VC).

As such, the social embeddedness of the transactions under scrutiny seems to restrain the level of conflict in the VC-E relationship during the trade sale exit process.

Discussion

What emerges from the empirical findings discussed in the previous sections is a picture of a breakup process recognized more often by its civility and cooperation than conflict. While some heated discussion emerged between the VC and the entrepreneur in several of our cases during the exit process, a consensus was reached in every single case.

Further, our findings give support to the statement that VCs' ability to initiate an exit process unilaterally is generally overstated in the literature (Smith, 2005). The acquirer in a venture capital-backed trade sale process typically does not want to acquire only the organization, but also the human capital intrinsic in the founding team and other employees, a point emphasized by several of our informants. In the words of the Flame VC:

> In most cases, VCs own a majority as a pool, but they don't really have the authority to sell even then. That is, they have the authority, but they don't have the ability, because the buyer is going to say: 'Okay, if he [the founder] leaves, this is a mess. I'm going to pay you a million bucks instead of a hundred million, because I'm going to have to fix this.'

Thus, a major rationale for the cooperative VC-E relationship observed in our data might be the interdependence inherent in the trade sale exit process; VCs require the cooperation of entrepreneurs in order to maximize the return generated from the exit event (Martin et al., 2007), while the entrepreneurs are dependent on a cooperative relationship with their investors in order to secure venture success (Cable and Shane, 1997; Sapienza and Korsgaard, 1996; Shepherd and Zacharakis, 2001; Steier and Greenwood, 1995).

However, as indicated, the legal rights of the VC stated in the investment contract can be emphasized during the discussions between the VC and entrepreneurs that emerge as the trade sale process is initiated. As such, contracts should not be completely dismissed as an important variable influencing the VC-E relationship. Instead, we argue that it should be considered an important backdrop for the discussion, as has previously been argued for the governance of syndicates (Wright and Lockett, 2003).

Following the argumentation of agency theory, contracts might therefore play a mediating role in the VC-E relationship by creating incentives for entrepreneurs to act in their principal's interests. While agency theory therefore is instrumental in understanding aspects of the VC-E relationship, we argue that one needs to include the concepts of goal congruency, procedural justice and social embeddedness to fully appreciate the complexity of the situation.

Alignment and Procedural Justice

Viewed from the entrepreneur's perspective, we have shown that all the entrepreneurs interviewed drew attention to the point that they knew the hidden cost of acquiring venture capital – namely that an exit event will have to take place in the future. As such, it is easy to agree with the investors who stated that "all entrepreneurs" should know that there must be an exit event when seeking venture capital. This entrepreneurial understanding of what it means to invite external investors to fund the venture might not always be the case, however. Several entrepreneurs are motivated more by non-pecuniary benefits such as control than the potential wealth that can be attained, and might not realize the trade-off they are making when attaining venture capital funding (Wasserman, 2008).

When it often should be the starting point of any venture capital investment that the most likely exit vehicle will be that of a trade sale, it is therefore highly relevant to make sure that the entrepreneur is willing to participate in such a process. As such, it is puzzling that it seems that not all investors worry about checking alignment with regards exit. Granted, as shown, some investment opportunities are looked upon by investors as more likely to go all the way to an IPO, making an argument for why one might not stress exit alignment and willingness to exit via trade sale for all deals. However, under the assumption that an entrepreneur always will agree to exit via an IPO, but might oppose a trade sale, it would be prudent by investors to ensure that the entrepreneur is willing to perform a trade sale at some point in the future.

We therefore argue that investors should explicitly discuss the potential for a trade sale exit with entrepreneurs prior to investment, even when it is not the probable exit vehicle. Herein also lays a major rationale for the inclusion of drag-along rights in term sheets. Should they not agree fully when the decision is made, procedural justice theory predicts that it will be easier to accept the decision nonetheless, hindering conflict. If no such alignment check is performed, a higher potential for conflict between the VC and the entrepreneur in case of a trade sale exit process exists. Accordingly, we posit that:

> *P1: The higher the level of alignment with regards to trade sale being an accepted exit vehicle prior to investment, the lesser the conflict between the VC and the entrepreneur during the trade sale exit process.*

Strategic Hurdles and Personal Motives

Managers of the target in an acquisition process affect whether the buyer succeeds. In opposition of popular belief, however, recent research has shown that acquisition processes are not always viewed as a negative by the incumbent management. In fact, management teams might take a proactive stance towards being acquired, given the presence of significant strategic hurdles or personal motives (Graebner and Eisenhardt, 2004). Our findings from 18 acquisition processes of venture capital-backed ventures lend support to this view also for entrepreneurial companies. Even though entrepreneurs are emotionally attached to their ventures (Baron, 1998), arguably more so than hired management teams, we have documented several instances of entrepreneurs proactively working towards the completion of the trade sale. These entrepreneurial teams were not only *willing* to be acquired, they *wanted* to. As shown, such attitudes were closely linked to the presence of significant strategic hurdles or personal motives. Accordingly, we posit that:

> *P2a: The greater the perception of the entrepreneur that the venture faces strategic hurdles, the lesser the conflict between the VC and the entrepreneur during the trade sale exit process.*

> *P2b: The greater the personal motives of the entrepreneur to be acquired, the lesser the conflict between the VC and the entrepreneur during the trade sale exit process.*

The Importance of a Reputation

VCs, who over a long term have built a substantial positive reputation, are likely to enjoy significant benefits in terms of deal flow and deal terms. Better connected VCs also outperform those with a less valuable network, as measured by the proportion of investments that are successfully exited via IPO or trade sale (Hochberg et al., 2007). Younger VCFs, on the other hand, have been found to take portfolio companies public prematurely, likely in order to build a reputation of success towards investors (Espenlaub et al., 2009; Gompers, 1996; Neus and Walz, 2005). These findings indicate that younger VCFs, having built no substantial reputation towards entrepreneurs, face a lower opportunity cost of defection in the VC-E relationship. Thus, we argue that a more reputable and well connected VC will have more to lose from acting in a non-cooperative manner. Accordingly, we posit that:

P3a: The better connected the VC is, the lesser the conflict between the VC and the entrepreneur during the trade sale exit process.

P3b: The more reputable the VC is, the lesser the conflict between the VC and the entrepreneur during the trade sale exit process.

The VCs' strong focus on maintaining their reputation, even to the degree that they are willing to forego financial return in order to make sure that everybody wins, seems to put them in a weak position vis-à-vis entrepreneurs. We argue, however, that entrepreneurs need to maintain a reputation of their own. The entrepreneurial recycling triggered by acquisitions (Mason and Harrison, 2006; Stuart and Sorenson, 2003), means that many of these entrepreneurs will soon find themselves in a situation where they are either seeking funding for their next venture, or where they in fact are sitting on the other side of the table seeking to fund entrepreneurial ventures themselves. With the widespread use of syndication of venture capital investments (Bygrave, 1987; Bygrave, 1988; Lerner, 1994; Wright and Lockett, 2003), either of these situations are likely to put entrepreneurs into touch with individuals who know how they behaved last time around. However, we realize that entrepreneurs, unlike VCFs, might not plan to remain in the entrepreneurial community, with retirement as one obvious reason for leaving. The opportunity cost of damaging one's reputation by acting non-cooperatively is arguably lower if this is the case. Accordingly, we posit that:

P4: The more likely the entrepreneur is to continue a career within the entrepreneurial community, the lesser the conflict between the VC and the entrepreneur during the trade sale exit process.

The figure below sums up our propositions and the posited influence on the VC-E relationship during trade sale exit processes.

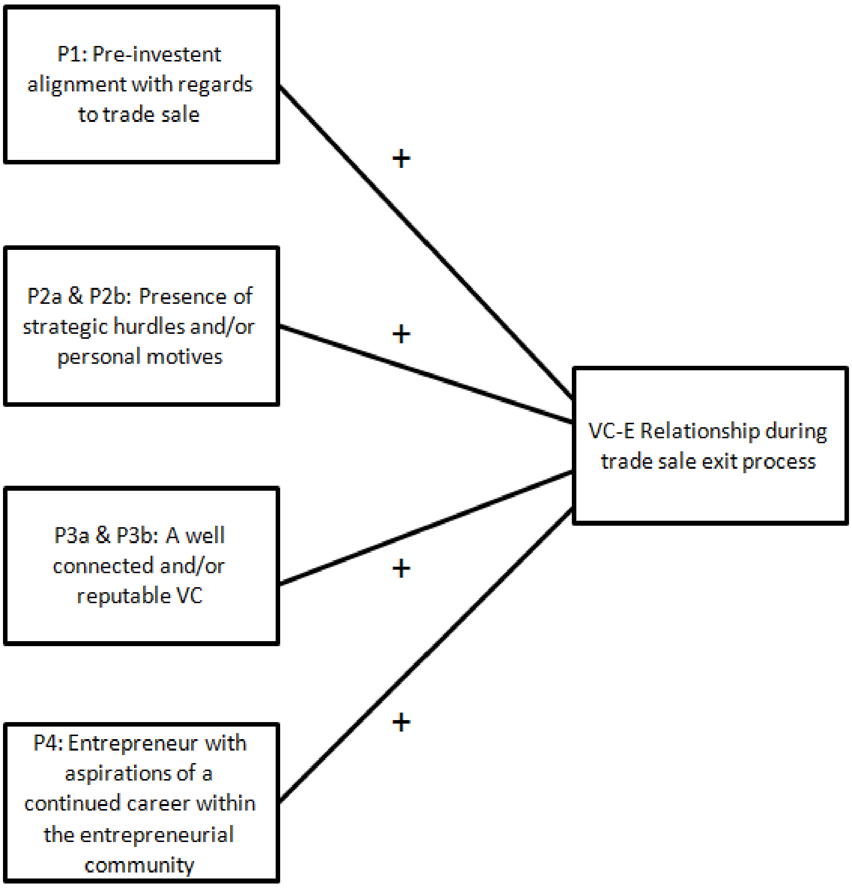

Figure 1 - Factors Influencing the VC-E Relationship during Trade Sale Exits

Conclusions and Implications

The subject of venture capital trade sale exits has received unproportionally low attention from scholars. Trade sale exits by far dominate as the most common venture capital exit vehicle, yet it is the IPO which has received all of the glory in the academic literature. Based on the notion that this neglected but extremely important topic was basically a black box when it came to research-based knowledge, this study set out to take the first few steps towards opening that black box.

Due to the importance of a cooperative relationship between the VC and the entrepreneur during a trade sale exit, this paper therefore sought answers to the following research questions: (1) What characterizes the VC-E relationship during trade sale exit processes? (2) Which, if any, factors influence the cooperative level of the VC-E relationship during a trade sale exit process?

Via a multiple-case study, covering 18 trade sale exit processes performed by Norwegian and U.S. VCs, we have thoroughly shown that the relationship between the VC and the entrepreneur during trade sale exit processes is one of consensus-driven decision making and cooperation. While differences of opinion and heated discussion regarding which path was the correct way forward for the portfolio company was documented for several cases, in the end, the decision to proceed with the trade sale was based on consensus in all cases covered.

Further, based on insights from the concepts of agency theory, goal congruence, acquisition as courtship, and social embeddedness, we have shown that several factors influence the degree of cooperation in the VC-E relationship during trade sales. These factors include pre-investment alignment with regards to the exit, the strategic hurdles and personal motives faced by the entrepreneur, the reputation and network connectedness of the VC, and the probability for entrepreneurial recycling.

Implications for Practitioners

Our results indicate that there are several steps that should be taken by VCs in order to maximize the probability for a cooperative relationship with the entrepreneur during the trade sale exit process. First of all, investors should ensure alignment with regards to trade sale being an accepted exit vehicle pre-investment. Even when an IPO is the pre-planned strategy, ensuring such acceptance would be prudent. Further, VCs should take the effect of strategic hurdles and personal motivations into account when timing the exit process. Granted, many trade sale exit processes are initiated due to an unsolicited bid, in which it is hard for the VC to influence the timing of the process. In those cases where the process is initiated proactively, however, it can be beneficial for investors to overlap the timing with the existence of such challenges, in order to maximize entrepreneurial willingness to sell. Finally, VCs should realize the importance of a strong reputation towards entrepreneurs, and the potentially devastating effects of acting in a non-cooperative manner during a trade sale exit process. Foregoing financial return in a specific deal where the entrepreneur has significant objections may be significantly outweighed by the positive, long-term effects.

On the other end of the relationship, entrepreneurs first of all need to realize the sheer prevalence of trade sale exits. As such, when entering into a relationship with a VC, the entrepreneur should be prepared for the possibility that there will be an acquisition event in the future. Entrepreneurs also need to realize the motivating effects of strategic hurdles and personal motives, and that timing a trade sale exit with their presence might be a beneficial way of ensuring a cooperative bias from the general management team. Finally, entrepreneurs who envision themselves continuing a career within the entrepreneurial community should also realize the importance of a positive reputation.

Implications for Further Research

The empirical data gathered in this study was based on a strategic sampling of completed trade sale exit processes in Norway and the U.S. Based on this data and the theoretical backdrop described, we have put forward several important propositions regarding the VC-E relationship during a trade sale exit. Cooperation between the VC and the entrepreneur during this process is necessary to ensure a positive outcome for all parties involved. Based on the prevalence of trade sale exits, high levels of VC-E cooperation during their execution may therefore be important for the overall well-being of the venture capital industry. As such, further research should investigate whether or not our propositions will survive empirical testing over a statistically representative sample. Thus, the next logical steps are to operationalize the propositions put forward into testable hypotheses, and subject them to the rigor of quantitative research strategies.

Importantly, all the entrepreneurs who were informants in this study realized the VCs' need for an exit event prior to seeking investments. The point of procedural justice theory that one is more likely to accept the decision itself if the process is deemed to be fair, could indicate that entrepreneurs that do not share this understanding would be more likely to deem the decision process regarding the exit as unfair. Therefore, they might also be more inclined towards protesting and acting opportunistically towards the investor in order to block the exit. While we have no empirical evidence that this is the case, it would be very interesting for scholars to investigate whether or not such a lack of education among entrepreneurs could be part of the explanation why immature venture capital markets underperform established markets such as the U.S.

Further, our data seems to suggest that some VCs value the importance of pre-planned exit strategies and pre-investment alignment more than others. Previous research have in fact hinted to the presence of two different types of investors, with one type being more inclined to tailor the company towards an exit, while the other believes in building the best possible company regardless of what the future exit might look like (Relander et al., 1994; Wall and Smith, 1997). While we have not delved into this subject in this paper, it would be very interesting to look closer at whether or not different investor types exist, and what the consequences of such different views are.

Finally, although not elaborated on in this study, it could be very interesting to investigate the role of financial advisors in mediating the relationship between the entrepreneur and the VC during the exit process. Many trade sale exit processes involve such advisors. However, very little is known with regards to how these actors are chosen, why they are contracted, and whether or not they have a significant influence on the process itself. In fact, to the authors' knowledge, there exist no studies focusing on the role of such advisors in venture capital trade sale exits. As such, this should be an area ripe for exploration.

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Appendix 1 – Trade Sale Exit Processes: Conflict or Consensus?

Case	Trade Sale Exit Processes: Conflict or Consensus?
Avalanche	**VC:** "They were happy with the valuation, and I think they were happy with the timing as well. In the end, it was an all agreed to solution to sell. And as a matter of fact we still have a good relationship. I still talk to all those founders."
Blackhawk	**Entrepreneur:** "...so, they [VCs] accepted the fact that, first of all, they were happy that we were in the process [initiated by management], they recognized that we had a competent representative, and so they were happy to sit back and just be informed. He [VC] was very happy with the valuation. I mean, he wound up with getting maybe 8 or 9 times his money."
Bruin	**Entrepreneur:** "The exit process was stressful, but I found the VCs to be very empathetic. They understood our motivation for world domination, and we understood their need for an exit. So being acquired by [company] was the best way to achieve both our goals." **VC:** "I had a clear impression that the founders were motivated to sell. The exit process was very smooth. We did not have any major conflicts."
Canuck	**VC:** "I think they [the founders] were very ready for it as well. ... So they were excited about the prospect. And we wouldn't have pushed it if the management team wasn't prepared to do it."
Coyote	**Entrepreneur:** "We [management and investors] were very aligned with regards to the exit." **VC1:** "It was a very smooth process, with basically no conflicts." **VC2:** "All actors, management and investors, were in agreement when it came to the exit process."
Flame	**VC:** "The entrepreneur was onboard with regards to selling the company, so there were no major conflicts during the exit process."
Flyer	**VC1:** "The founding team members who were still an active part of the company were very interested in the sale taking place. There were some discussions with regards to pricing, but the term sheet is pretty clear about who can stop or start a sale, so those discussions were rather easy. No major dispute arose." **VC2:** "We were all very much aligned with regards to the exit."
Hurricane	**VC:** "It was very easy to agree with the founders that this was a good time to sell."
Islander	**Entrepreneur:** "There were no conflicts or anything like that. There has never been any disagreement with regards to the fact that there would be an exit."
Lightning	**VC:** "Investors and managers were in unison agreement that it was reasonable. We all agreed that selling was the right thing to do."
Oiler	**Entrepreneur:** "We had a very cohesive management team that believed that the path that we were taking was the right path, and while there were some investors who thought that maybe we were selling too early, at the end of the day everybody kind of got on the same page and recognized the fact that it was the right thing to do, and were supportive of doing it."
Panther	**VC:** "In most cases it's no problem getting the management to go along with a trade sale. This case was no different. We agreed upon a trade sale, we agreed upon the intermediary to be used, and we initiated the process. It was no problem."
Penguin	**Entrepreneur:** "We were very much in agreement with the need to sell. Now, as we approached the exit process, the VC increased his focus on the numbers, which sometimes meant that what we felt was in the long term interest of the company was not considered enough. It strained the relationship, but in hindsight, I have only good things to say about them."

Ranger	**VC:** "There was some heated discussion around the timing of the sale. Perhaps the entrepreneur wanted to take the company further, and it's not always attractive being incorporated into a major entity as opposed to running an independent company. Some discussion and conflict arose. But in the end, after a lot of dialogue, we all came to agreement. And that was based on the longstanding relationship between us."
Sabre	**VC:** "So, the attitude of the founders was that: 'I think you're selling too soon, you're giving up on the company.' So, our concern was that their motivation was perhaps to ride out the storm. So you have that conflict. But, I think in the end, given the price that was put out there, and people started doing the calculations in their head of how much money they were going to make, everybody walked away pretty pleased at how it ended."
Senator	**VC:** "In the end, we all agreed that an exit was the most attractive choice…"
Star	**VC:** "It's very important, as you enter a trade sale process, that it is deeply anchored with the management team – that it is something that they want to do. Therefore, we are very focused on being open with the founders with regards to these processes. So there was full agreement between us as investors and the management team at all times."
Thrasher	**VC:** "The founders were definitely onboard with the exit."

Appendix 2 – Entrepreneur: Do You Want What I Want?

Case	Do You Want What I Want?
Blackhawk	**Entrepreneur:** "Oh, yeah, exit was something that we discussed a lot with the VCs prior to raising funds. But, in those days, the traditional exit was always an IPO. So we saw ourselves as going public."
Bruin	**Entrepreneur:** "It's important for entrepreneurs to signal to the VCs that they realize there will be an exit. The venture capital business model depends on the exit, and if you're going to have a good relation with your investor, you have to be able to align around that. If you act like you are aligned with regards to exit, but don't really believe in it yourself, there's going to be a conflict somewhere in the future. And that's a conflict you're going to lose."
Islander	**Entrepreneur:** "You cannot invite investors, and then turn around and not want to sell the company. So the path towards investor exit is something that is discussed from day one."
Oiler	**Entrepreneur:** "We didn't have a ton of conversations about the exit. We talked about the industry that we were in, and talked about some of the type of acquisitions that get made in that space. But frankly, at that stage, you're really less focused on the exit, and more focused on the market opportunity and what it's going to take to build a great company. So, we were pretty agnostic to what the long term exit might be."
Penguin	**Entrepreneur:** "It was crystal clear for us that there would be an exit when we sought funding. We knew what the VCs were about."

Paper 4

The Choice of Financial Advisors in Venture Capital Trade Sale Exits

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Abstract

This paper investigates the factors affecting the choice of financial advisors in venture capital trade sale exits. A multiple-case study of 19 venture capital trade sale exits performed by both Norwegian and U.S. venture capitalists has been conducted in order to shed light on this phenomenon. We find that venture capitalists emphasize many of the factors suggested by the general literature on financial advisors. However, we find an extension to both the rationale for hiring an advisor and the factors affecting the choice of an advisor in a venture capital trade sale. We therefore offer a framework that integrates previous research and our findings to explain the process in which financial advisors are chosen in a venture capital trade sale.

Introduction

The ultimate event that separates the venture capitalist (VC) and the portfolio company in a venture capital fund is the exit event. The exit preferably takes the form of an initial public offering (IPO) or a trade sale (Cumming and MacIntosh, 2003). Entrepreneurial ventures are typically cash-constrained, with no ability to pay dividends, and it is capital gains from the exit event that will determine the return to the venture capital fund, and thereby its investors (Cumming et al., 2006). Thus, exit is at the heart of venture capital (Cumming and MacIntosh, 2003).

The sale of the entire portfolio company to a third party, i.e. a trade sale, is the most common exit vehicle. When turning to the empirical world, this is evident: According to the National Venture Capital Association, six trade sales were conducted for every IPO in the U.S. between 2004 and 2010 (NVCA, 2011). Statistics both from Europe as a whole, and the Nordic region alone, support these findings (EVCA, 2010; Vækstfonden, 2009).

Despite the importance of trade sale exits for venture capital, the research on this exit vehicle is lacking. Most effort in exit research is directed towards IPOs, due to data availability and the view of IPOs as more prestigious than other exit vehicles (Chaplinsky and Gupta-Mukherjee, 2010; Dimov and Shepherd, 2005; Félix et al., 2008; Giot and Schwienbacher, 2007; Isaksson, 2000; Megginson, 2004). When studying merger and acquisition (M&A) issues in general, most research has taken the perspective of the acquirer (Graebner and Eisenhardt, 2004), providing little help to shed light on the trade sale exit vehicle. Moreover, emphasis in the M&A research discipline has been on publicly traded companies (Capron and Shen, 2007). However, some practitioners have looked at the sell-side exit process (Hansen, 2001; Rosenbaum and Pearl, 2009).

When completing an M&A transaction, a financial advisor can be engaged to enhance deal proceeds (Servaes and Zenner, 1996). Such an actor is specialized in facilitating and completing transactions, by having extensive networks and skills in information processing and negotiations. Different scholars have found different indications on how common advisors are, with frequencies varying from 35 % to almost 100 % for a target company (Forte et al., 2010; Kesner et al., 1994; Thomas, 1995). Some M&A research has taken the target's choice of advisor into account (Forte et al., 2010; Kale et al., 2003; Ma, 2006). However, despite their prevalence, no study on the role and use of financial advisors for venture capital trade sale exits has been conducted.

The aim of this study is therefore to combine insights from the literature on venture capital, M&A, and financial intermediaries to explore the use of financial advisors in venture capital trade sale exits. The following two research questions are sought answered:

- Why do venture capital-backed companies engage financial advisors in trade sales?
- What factors influence the choice of a specific financial advisor?

To answer these questions, we have conducted a multiple-case study that includes 19 Norwegian and U.S. entrepreneurial ventures that were sold between 1996 and 2011. Semi-structured interviews with VCs and members of the top management in said cased are used to shed light on the decision making process with respect to the research questions.

The study shows that there are differences in what factors venture capital-backed companies and companies in general use when evaluating and choosing advisor. With respect to the first research question, we find that VCs put more value on the bargaining skills advisors have in negotiations with the opposite party than their ability to identify acquirers that allow for superior synergies. Regarding factors that influence the choice of an advisor, we unveil eight distinct categories. In line with current research-based knowledge, we find that industry experience and prior relations with the target company or its investors are factors that increase the probability of being engaged as an advisor. Additionally, we find extending factors specific for venture capital trade sale exits. Finally, we create a framework that integrates this knowledge, and explains the rationale for hiring an advisor, the factors influencing the choice, and the roles played by such advisors in the trade sale of a venture capital-backed company.

The contributions from this paper can be summarized in the following points: First, this is the first study that explicitly examines the relation between VCs and financial advisors from an exit perspective and it is one of few studies that use the trade sale exit vehicle as a vantage point. Second, and similarly, this is one of the few studies taking the perspective of the sell-side company in an M&A process. Third, the study at hand contributes to the limited research on targets' financial advisors, by offering explanations to why and how advisors are engaged in venture capital trade sale exits.

The rest of this paper is structured as follows. Section II presents the current literature on financial advisors and develops a theoretical framework. Section III gives an overview of the methodology used in this study, while the empirical findings from the study are presented in section IV. Section V provides an analysis of the research questions in addition to a discussion that compares the theoretical framework and the empirical findings. Section VI concludes, suggests implications for practitioners, and offers proposals for further research on this topic.

Theoretical Background

As described in the previous section, no study has looked specifically at the relation between financial advisors and the trade sale of venture capital-backed companies. In order to develop a theoretical background for the following analysis, we will therefore depart by looking at the literature on financial advisors in general. We will continue by studying the two different types of company sales, before synthesizing this knowledge in a theoretical framework.

A Review of the Literature on Financial Advisors

The research on financial advisors in M&A transactions has focused on two areas: (1) the effects on shareholder wealth from advisors and factors affecting the choice of advisors, and (2) factors affecting the fees paid to advisors and fees' impact on deal outcome (Forte et al., 2010). With the aim of this study in mind, our main focus will be on the former area, although both areas will be presented.

Effects on Shareholder Wealth and Factors Affecting the Choice of Advisors

Financial advisors are engaged in M&A processes because they are specialists in producing and processing information (Allen et al., 2004). A financial advisor can contribute to shareholder wealth in two principal ways, denoted as the better merger hypothesis and the bargaining power hypothesis (Bowers and Miller, 1990).

The better merger hypothesis, alternatively coined the matchmaking or superior deal hypothesis, means that the advisor can suggest targets or bidders that result in greater synergies (Bowers and Miller, 1990; Ma, 2006; Rau, 2000; Schiereck et al., 2009). Some scholars claim that transaction costs are the reason why financial intermediaries are able to propose more profitable M&A partners, and that transaction costs give such actors a comparative advantage due to economics of specialization, scale economics in information acquisition, and reduction in search costs (Servaes and Zenner, 1996).

The bargaining power hypothesis is derived from the fact that the offer amount in an M&A process determines the distribution of gains between the acquirer and acquire. The acquirer wants to make an offer that is high enough to be accepted, but not transfer wealth to the shareholders of the target firm. On the other hand, the seller wants to reap the highest possible price for its assets. If an advisor possesses superior negotiation skills, he can extract a larger share of the acquisition benefits for the party he represents (Bowers and Miller, 1990). Other scholars have a slightly different interpretation of this hypothesis, claiming that bankers, with extensive experience in executing deals, can bring more bidders to the table, and thereby increase the bargaining power of targets (Ma, 2006).

Servaes and Zenner (1996) distinguish between three functions of a financial advisor. First, an advisor can reduce the transaction cost of the firm by identifying potential buyers and targets, evaluating the deal, and putting together an offer. This is equivalent to the better merger hypothesis presented above. Second, an advisor can reduce asymmetric information between the parties (Stuart et al., 1999). The asymmetric information may be especially evident for entrepreneurial ventures, because the value of such ventures is to a larger degree derived from intangible assets and future growth opportunities than more mature companies (Gompers and Xuan, 2009; Ragozzino and Reuer, 2007). Third, contracting costs in an M&A process can be reduced by an advisor, because putting their reputation at stake sends a signal of quality.

When turning to the empirical world, most research has focused on the acquirer's choice of advisors and corresponding wealth implications (Forte et al., 2010; Ma, 2006). In order to get a broader view of the empirical results, we present findings from both perspectives.

Attempts to test the wealth implications of hiring bankers in M&A transactions have been inconclusive. Bowers and Miller (1990) find that transactions that include a first-tier advisor (i.e. a prestigious and large advisor) on either side create more wealth, which supports the better merger hypothesis. However, the same scholars find no support for the bargaining power hypothesis. Servaes and Zenner (1996) find no wealth effect from advisor reputation, a result that is supported by Rau (2000) and Schiereck et al. (2009). By introducing a relative reputation measure between the bidder's and target's advisors, Kale et al. (2003) find that the wealth gains to the bidder or target increases with the relative reputation of either side's advisor and that a more reputable advisor creates more gains from the transaction, providing support for both hypotheses. Ma (2006) looks specifically at the target's advisor, and finds support for both hypotheses, although stronger evidence for the better merger hypothesis.

When Forte et al. (2010) find that one-third of the transactions in their sample did not comprise an advisor, their claim that the choice of hiring an advisor is nontrivial seems reasonable.

Several scholars have tried to identify determinants of whether to hire an advisor or not. Forte et al. (2010) find that the choice of engaging an advisor on the sell-side is positively correlated with the complexity of the deal and the reputation of the bidder's advisor. Servaes and Zenner (1996) explores reasons for the acquirer to hire an advisor, and find that limited acquisition experience, deal complexity, and a diversified target are all factors that enhance the likelihood of engaging an advisor. Kale et al. (2003) explore both the bidder's and target's rationale for engaging an advisor, and find that a hostile bid, a large deal and little experience are driving factors for the bidder. Deal complexity and size of target and bidder are factors increasing the probability of hiring an advisor for a target company.

As an extension of this issue, a part of the literature has focused on factors that influence the choice of a specific financial advisor. Chang et al. (2010) find that industry expertise and a prior relationship with the prospective client increases the probability of an advisor to be chosen by a specific bidder or target. In addition, these scholars find that if an advisor has done business with the bidder (target), it is more likely to be chosen by the target (bidder). Further, a target company's relationship closeness with its main bank increases the likelihood of this bank being chosen as a financial advisor (Forte et al., 2010).

As this section shows, scholars have found different motivations for hiring an advisor and what factors that lead to the choice of a specific advisor. Moreover, the advisor's effect on the wealth creation in M&A transactions is disputed. This has led scholars to explore the incentive structure offered to advisors by their principals, an issue to be examined in the following paragraphs.

Fee Determinants and Fee Influence on Transaction Outcome

Typically, merger fees are around one per cent of the transaction value (Hunter and Jagtiani, 2003; Servaes and Zenner, 1996). These fees are paid according to contracts agreed upon between the company and its advisor. In general, an advisor can be incentivized by one of the following contract forms: share-based contracts, value-based contracts, and fixed fees. (McLaughlin, 1990; McLaughlin, 1992).

Share-based contracts are most relevant for buy-side advisors, because the advisor is remunerated based on the number of shares it is able to acquire in the target. The fee can either be a linear or a step function. Value-based contracts are divided in two different types, total-value fees and incremental-value fees. Total-value fees can provide the advisor with a constant percentage fee of the deal value, a constant dollar fee upon completion of the transaction, or a variable percentage fee, where the percentage fee is dependent on the deal value. The constant percentage fee is the most common for a target advisor, while the constant dollar fee is more common for advisors on the buy-side (Calomiris and Hitscherich, 2007). Incremental-value fees specify a benchmark transaction price, and the advisor is only granted a fee if the transaction value exceeds this benchmark price. Fixed-fee contracts give the advisor the same fee whether the transaction consummates or not, and are thereby not contingent on outcome. These contracts are mostly used in combination with the other two contract forms. Fixed-fee contracts can be of two different kinds: a retainer fee that is paid to the advisor every month it is engaged, and an opinion fee that is paid in order to have the advisor complete a fairness opinion, evaluating whether the transaction is fair or not seen from a financial perspective (Calomiris and Hitscherich, 2007).

Research shows that the most common contract is a fixed fee in addition to a fee that is contingent on the completion of the transaction and based on the transaction value (Hunter and Walker, 1990; McLaughlin, 1990; McLaughlin, 1992). In a study of acquisitions of public targets, McLaughlin (1990) found that approximately 80 % of the fees in an average contract are contingent on the transaction to be completed. This means that advisors have a strong incentive for completing the deal (Rau, 2000), and contingent fees might actually expedite deal completion, according to some scholars (Hunter and Jagtiani, 2003).

The Two Different Types of Company Sales

Two different procedures can be applied when selling a company: one can either conduct an auction or a negotiated sale (Boone and Mulherin, 2007; Macey, 1990). An auction is in general defined as a market institution that incorporates a set of rules with the aim of allocating resources and prices based on bids from market participants (McAfee and McMillan, 1987). When applied in a company sale context, an auction means that the company for sale tries to generate bids from multiple prospective buyers with the aim of maximizing the price paid for the company (Boone and Mulherin, 2007). A negotiated sale, on the other hand, is a direct negotiation with one prospective buyer (Boone and Mulherin, 2007; Rosenbaum and Pearl, 2009).

The common understanding is that auctions lead to more competition, a higher valuation of the entity for sale, and thereby should be the preferred way of conducting a company sale (Boone and Mulherin, 2007; Macey, 1990). Moreover, Bulow and Klemperer (1996) develop a model that shows that an auction is always better than a negotiated sale if the auction is able to attract one additional bidder. However, in a study of 400 takeovers completed in the 1990s, Boone and Mulherin (2007) find that auctions and negotiated sales represent roughly half of the takeovers each. They also find that the wealth effects in a negotiated sale and an auction are comparable.

This result may be surprising, but can be explained in different ways. Boone and Mulherin (2007) view the choice between auctions and negotiations as a trade-off between two different hypotheses: the agency cost hypothesis and the information costs hypothesis. The agency cost hypothesis states that an auction will generate higher revenues than a negotiated sale, and that shareholders will be suffering if an auction is not conducted. The information cost hypothesis, on the other hand, claims that conducting auctions is expensive, and that the cost of conducting the auction will determine what type of sale that is the most profitable. Hansen (2001) proposes that an auction generates a competitive information cost. This cost arises because prospective buyers need information to evaluate the entity for sale. Many of the potential buyers are possibly operating in the same industry as the auctioned company, and the information they gather as a part of the bidding process may also be used by the bidders in their roles as industry actors. This implies that releasing proprietary information may reduce the value of the entity for sale, because the new information can reduce the bargaining power of the target.

The academic research on what actually happens in the sales process, be it auction or negotiated sale, is limited. Of course, the better merger and bargaining power hypotheses outlined in the literature review explains some of the advisor's responsibilities, but a more detailed description is lacking. In contrast to the limited academic research on the company sales process, several practitioners have contributed in the field (e.g. Bruner, 2004; Frankel, 2005; Hansen, 2001; Hooke, 1997; Rosenbaum and Pearl, 2009).

With respect to auctions, Rosenbaum and Pearl (2009) model the process as consisting of the following stages: organization and preparation; first round; second round; negotiations; and closing.

In the organization and preparation phase, the sell-side advisor gains an understanding of the seller's objectives, performs a valuation, selects prospective buyers, and prepares marketing material such as a teaser and the confidential information memorandum. The first round is initiated when the advisor contacts potential buyers and distributes the teaser and a confidentiality agreement. The information memorandum is distributed upon signing of confidentiality agreements. Ultimately, initial bids are collected, and based on these some of the bidders are allowed to enter the second round. In the second round, site visits and management presentations are conducted, and selected buyers are granted access to the data room. Thereafter, the advisor drafts the definitive agreement and receives final bids based on this draft. The final bids are evaluated in the negotiation stage, and negotiations are initiated with the preferred buyer. This stage ends with board approval and signing of the definite agreement. Necessary public approvals are obtained in the closing phase.

For a negotiated sale, Rosenbaum and Pearl (2009) claim that the process will follow roughly the same steps as an auction, but exclusively targeted towards a single buyer. A negotiated sale is likely to complete in a shorter time, because the prospective buyer often takes initiative to the deal, and therefore does not need to be educated on the industry and the target during the process. Nevertheless, the sell-side advisor needs to prepare some marketing material, coordinate management presentations, assemble material and provide access to the data room, and facilitate the negotiations.

Theoretical Synthesis

The literature review conducted confirms our claims given in the introduction: few studies look at the target's choice of, and rationale for, hiring an advisor, and furthermore, no study looks specifically at these questions from a venture capital-backed company's point of view. Therefore, based on the current literature on financial advisors, we have developed an initial framework to describe the process of hiring an advisor and the sales process that follows. This framework is shown in figure 1.

The model departs from the question of whether or not the firm wants to engage an advisor. As described earlier, this is not a trivial choice. If the firm chooses to engage an advisor, some factors are found to affect the choice for the target firm, as seen in the second column of the model. Then the sale could take the form of an auction or negotiated sale, with their respective processes described in the model.

This model is a general description of a target's engagement of financial advisors as well as the actual sales process that follow. However, as suggested above, no scholars have explored these issues in the context of venture capital portfolio ventures that are up for sale. It is therefore highly interesting to explore whether the same rationale for hiring advisors is evident for venture capital-backed companies, if the same factors are emphasized when choosing a specific advisor, and if the actual sales process takes the same form as outlined above. In search for answers to these issues, we look to the empirical world.

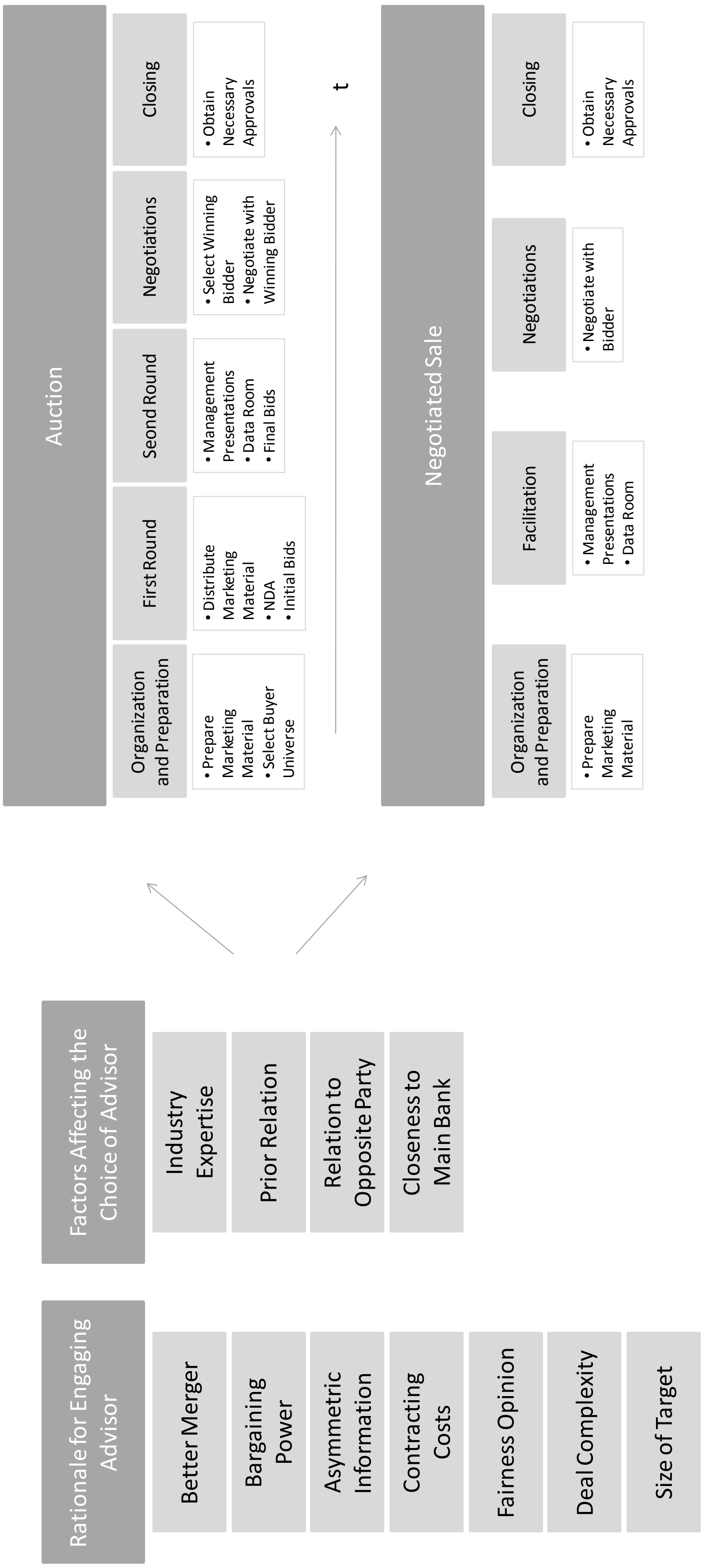

Figure 1 - Overview of Sales Process

Methodology

The research design utilized in this study is a multiple-case, inductive study involving 19 venture-backed trade sale exit processes. Multiple cases allow for replication logic, where each case can be looked upon as an experiment. Inferences drawn from one experiment serves to confirm or disconfirm inferences drawn from the others (Yin, 1994). Multiple-case studies therefore allow for more generalizable and better grounded results than those of single-case studies.

Research setting

We chose venture capital trade sale exit processes as our research setting due to the limited research on the target's choice of advisors, both in M&A transactions in general and in venture capital trade sales in particular. Further, trade sale exit processes are an intrinsic part of the venture capital business model. With trade sales by far being the most common exit vehicle, their success to a large part dictates the success of the venture capital industry as a whole. However, this practical significance of the process is not reflected in the current venture capital research, where trade sale exit processes are still somewhat of a black box. Taking the first steps towards opening that box was a major motivation for the chosen research setting.

The fact that very little research has been done on venture capital trade sale exit processes motivated us to make this an inductive study. The choice of financial advisors in this setting has in fact never been explored before, and is therefore poorly understood. Quantitative research strategies would not be able to offer the same insights into the process as rich, qualitative data would. Further, trade sale exits are laden with sensitive issues. Interviews performed under the promise of confidentiality were viewed as the best method for gaining access to rich data.

Sampling

The cases included were based on a strategic sampling of completed trade sale exit processes. In total, we sampled 19 different cases. Several of the cases were identified as interesting by the researchers prior to initiating contact with the informants. As we immersed ourselves in the venture capital community, we were also introduced to several cases included in the sample by actors lending a helping hand. Given the fact that we were seeking to understand the entire sales process, we sampled only cases in which the trade sale had been completed. As an added bonus, this reliance on retrospective data increased the efficiency of data collection, allowing for the inclusion of more cases in the study.

We sampled firms from various industries. Further, trade sales completed by both Norwegian and U.S. VCs and entrepreneurs were included in the sample. By including various industries and different geographical regions in our sample, the generalizability of our results should improve. Seven of the 19 cases included in the sample are trade sales exits performed by U.S. VCs, while the remaining twelve were performed by Norwegian VCs. Moreover, 15 out of 19 companies engaged an advisor to help with the sales process. Five of the cases took the form of a negotiated sale, while the remaining 14 were auctions.

Table 1 below gives an overview of the cases in the sample, the type of advisor engaged, and the sales type. The advisors are grouped in three different clusters according to their characteristics: Investment Bank, Boutique M&A Firm, and Consultant. An Investment Bank is a bank that performs a broad range of financial services, such as M&A advisory, underwriting and stock research and trading. These firms often have offices in several countries. A Boutique M&A Firm, on the other hand, only offers M&A related services, and often specializes in certain geographical areas and industries. A Consultant is an individual hired on a fixed fee. As seen from table 1, seven companies engaged an Investment Bank; six engaged a Boutique M&A firm; while two of the firms used a Consultant.

Table 1 - Overview of Cases

Case	Industry	Type of Advisor	Type of Sale	Acquired	Informants
Avalanche	Cable	Investment Bank	Auction	2006	VC
Blackhawk	Sensors	Boutique M&A Firm	Auction	1998	CEO
Bruin	Electronics	Boutique M&A Firm	Auction	2006	VC, CEO
Canuck	Networking hardware	No advisor	Negotiated Sale	2005	VC
Coyote	Electronics	Boutique M&A Firm	Auction	2007	2 VCs, CEO
Flame	Networking hardware	No advisor	Auction	1996	VC
Flyer	Software	No advisor	Negotiated Sale	2007	2 VCs
Hurricane	Energy	Investment Bank	Auction	2007	VC
Islander	Oil service	Investment Bank	Auction (terminated), then Negotiated Sale	2007	CEO
Lightning	Software	Investment Bank	Negotiated Sale	2010	VC
Oiler	Wireless	Investment Bank	Auction	2006	CEO
Panther	Energy	Investment Bank	Auction	2007	VC
Penguin	Software	Boutique M&A Firm	Auction (terminated), then Negotiated Sale	2009	CEO
Ranger	Oil service	No advisor	Negotiated Sale	2008	VC
Sabre	Networking hardware	Consultant	Auction	1999	VC
Senator	Electronics	Boutique M&A Firm	Auction	2011	VC
Shark	Telecom	Investment Bank	Auction	2010	VC
Star	Telecom	Boutique M&A Firm	Auction	2006	VC
Thrasher	Healthcare	Consultant	Negotiated Sale	2011	VC

The trade sales included in this study were completed between 1996 and 2011. This time period experienced very different market circumstances, from the hot market of the late 1990's to the financial crisis in the late 2000's and the depression that followed. As such, the rationale for, and the opportunities to complete, trade sale exits for VCs have varied considerably over the time period covered. While it was relatively easy to launch an IPO in the U.S. in the late 1990's, it was next to impossible in 2008. This variance allowed for controlling for the influence of market circumstances. The cost, of course, was the possibility of informants not remembering events accurately anymore.

Data Sources

The study is based on several data sources: (1) qualitative data from semi-structured interviews with VCs and/or entrepreneurs, (2) e-mails to follow up interviews and ensure that we understood the accounts given correctly, and (3) archival data, including press clippings, company web sites and discussion forums.

We started with pilot interviews with informants who had considerable practical experience with trade sale exit processes, as well as academics with significant experience from the field of venture capital research. These interviews helped us form the two distinct interview guides to be used in VC and entrepreneur interviews respectively. In addition, it made sure that we as interviewers were well prepared before entering the next phase of the study.

We conducted 21 interviews with our key informants. Both VCs and entrepreneurs were interviewed in order to ensure that we were getting both sides of the story, and help mitigate subject biases (Golden, 1992; Miller et al., 1997). Utilizing multiple informants and seeing the picture painted by both ends of the dyad, also helps build a richer and more elaborated model (Schwenk, 1985).

The interviews varied in length from 30 to 70 minutes, and followed the aforementioned interview guides. The interviews followed a "courtroom" procedure, with the interviewers emphasizing the need to focus on facts and events rather than on interpretations (Eisenhardt, 1989). We always began the interviews by asking the respondents to recount the story of why they invested/sought investment, followed by a short recap of what developments took place within the portfolio company up until the actual exit process was initiated. Seeing that we were seeking retrospective reports, such open-ended questioning should lead to higher accuracy in our data (Lipton, 1977; Miller et al., 1997).

All of the interviews were tape-recorded and transcribed verbatim, totaling 197 pages of single-spaced transcriptions. As mentioned, we followed up the interviews with e-mails asking clarifying questions on an as-needed basis. Interviews with Norwegian informants were conducted in Norwegian, and translated into English by the authors. We strived to ensure that nothing was lost in translation.

When possible, we took steps to minimize informant biases. We interviewed both entrepreneurs and VCs. Thus, one would expect significant differences in their accounts of the events should retrospective bias be an issue (Seidler, 1974). We found no such difference. In addition, we always held the data provided in the interviews up against the archival data collected from secondary sources, in order to ensure that we were not suffering from being fed biased information.

Our informants were all highly knowledgeable and influential with regards to the exit process. Such informants are the most reliable (Seidler, 1974; Kumar et al., 1993; Huber and Power, 1985). Further, we emphasized during the interviews that we were interested in case-specific facts and events. Thus, the information provided is less likely to be subject to cognitive biases and impression management (Huber and Power, 1985; Golden, 1992; Miller et al., 1997). Finally, the trade sale exit process is highly sensitive, both on a personal level and business wise. We therefore promised confidentiality to our informants, in order to further motivate for the provision of accurate data (Huber and Power, 1985; Miller et al., 1997).

Data Analysis

Based on the triangulation of data from our different sources, rich and reliable mini-cases of each of the trade sale exits could be built (Jick, 1979). Thereafter, within-case and cross-case analyses were performed. The analysis started by looking closer at each case on a stand-alone basis. In the spirit of the inductive process, this analysis allowed for the emergence of constructs and relationships, and was not guided by specific hypotheses.

Following the stand-alone analysis of all cases, cross-case analysis was performed. Replication logic allowed for the confirming and disconfirming of tentative constructs and propositions. This process was highly iterative, with the researchers stepping back and forth between data and analysis. Further, a significant amount of time was set aside for discussion both within the team and with external researchers in order to ensure the validity of the emergent constructs.

Finally, as the findings from the study were ready for presentation, a sanity check was performed. All informants were contacted and asked to correct any final misunderstandings, as well as perform a citation check. In addition, they were given the chance to comment on the framework put forward and the logic behind our argumentation, in order to ensure a close connection between our results and the world as it is perceived by the practitioners.

Limitations

This study is based on a strategic sampling of completed trade sale exit processes. As such, the results are not statistically representative. The cases included took place over a long period of time. While this helped control for market circumstances, it does mean that the informants from the oldest cases may have remembered events inaccurately. Similarly, only two of our cases have both the VC and the entrepreneur as informants. Although we took steps to minimize informant biases, we cannot be sure that the information provided is how other stakeholders in the process experienced it. Bias and partial information may have affected our data. Interview data was triangulated with data from other sources in order to minimize the effect of this potential problem.

Findings

In this section, findings from the study will be presented. The findings are divided with respect to the two research questions: the rationale for hiring a financial advisor, and the factors determining the choice of a specific financial advisor.

Rationale for Hiring a Financial Advisor

As seen in the literature review, the decision to employ an advisor is not trivial. Some scholars claim that an advisor is almost always used (Kesner et al., 1994), while others find that a financial advisor is not that common in M&A transactions (Forte et al., 2010; Thomas, 1995).

This leads us to the first research question in this paper: What motivates a venture-backed company to hire an advisor?

Six different motivations became apparent when analyzing the data: Shield the Portfolio Company and VCs, Bad Cop, Valuation Assessment, Signal of Credibility, Create and Facilitate an Auction, and Facilitate Negotiation. Appendix 1 shows what kind of advisor the case companies hired, the kind of sale conducted, and the rationale behind the engagement of the advisor used for all the cases. The factors are elaborated on below.

Shield Portfolio Company and VCs

A factor put forward by several of the interviewees was that having an advisor lets the management of the company focus more on the day-to-day operations and the investors focus more on their primary activities. Entrepreneurial ventures are resource constrained, and may not have the necessary skills or human resources to conduct such a process without downgrading its focus on other parts of the business. For example, the Bruin VC thinks that their and the advisor's effort made it easier for the management to focus on the operation of the company. This was regarded as important, because the exit process took nine months from initiation to closing.

Knowing that a VC in average manages eight investments and is represented on five company boards simultaneously (Gorman and Sahlman, 1989), it is clear that an advisor can unburden the VC. This is mentioned by the Hurricane VC, stating the following:

> There is a lot of work to be done: You are going to create a presentation, put up a data room, do a vendor due diligence, and we are not expected to do this. We are on the board of these companies, and this is not a board job.

Accordingly, the Hurricane VC decided to engage an investment banker to help facilitate the trade sale.

Bad Cop

The role as a VC involves investing in and, hopefully, divesting numerous entrepreneurial ventures. A venture capital firm (VCF) often specializes in certain industries, which means that it will interact regularly with actors in these industries, including in sales processes. An advisor can therefore help maximize the sales price by being aggressive in the negotiations, while at the same time retaining a good relation between the VCF and the industry actors, who could be possible buyers for later portfolio companies. This is a factor presented by one of our informants:

> In our experience, it is preferable [to engage an advisor], because … we don't want to destroy the relation to a possible buyer, we talk with these guys continuously, and a financial advisor can be somewhat more aggressive when approaching possible bidders (Hurricane VC).

The same point can be made with respect to the management of the portfolio company for sale. The CEO and founder of Bruin puts it like this:

> … when we started the negotiations, the advisor took the role as 'bad cops', which was a good thing. … The advisor had the lead role in the negotiations. This was a conscious choice, because if the transaction closed, I was going to work for the acquirer. It was better to take a back seat role than being the bad guy.

The Sabre VC also appreciates this role of an advisor, shown by this quote:

> … when we or the intermediary had to play hardball with the potential acquirer. … If you put the acquire in that situation, they're now arguing with their future boss. … So, for me, the value of having an intermediary for that purpose was tremendous.

If a member of the management team is to facilitate the sales process, this can, as shown by the quotes above, create a conflict of interests. Is the manager going to act in the interests of his present or future principals? If he bargains aggressively, he will act in the interest of his current principals, but possibly create a bad relation with his future superiors. In the opposite case, if he lets the acquirer get most of the transaction proceeds, he will hurt his current principals (and his own wealth, assuming he is incentivized by stock), but act in the interest of his future superiors. In either case, having the advisor play the role of bad cop might help to solve the potential conflict of interest.

Valuation Assessment

It is not unlikely for the owners of a venture-backed entrepreneurial company to have different views on the timing and terms of a trade sale. A motivation for hiring an advisor may then be to perform an objective valuation of the entity for sale. If such a valuation shows that the price one can obtain from a sale is fair compared to the alternative of continued funding, it can create more alignment between the owners. This issue is put forward by the Oiler CEO:

> … [when] we first had a company make an offer to buy us, there was at least one investor who thought it was a bit premature to be selling. And so he was hopeful to get an outside banker's perspective on the market, and what people were paying, and what this company might be worth X years later as an IPO versus what we might be able to sell for today.

In the case of Lightning, the valuation assessment was more to explore if the offer received was reasonable, than it was to align the views between different shareholders: "We engaged an advisor in order to look at the offer; is this reasonable? Is it realistic to get a higher offer?" (Lightning VC). When the third-party concluded that the offer was fair, the VCs decided they wanted to move forward with the bidder.

Signal of Credibility

Another factor that emerged from the data was that an advisor can be a signal of credibility to potential buyers. An advisor in general, and more specifically a well-known and respected advisor, can show prospective buyers that the company is serious about selling, and can also help reduce the contracting costs between the parties (Servaes and Zenner, 1996).

As one of the interviewees formulates it: "…he [the advisor] was well respected by the acquirers too. He didn't come in with less attractive or challenged companies, he came in with good stuff" (Avalanche VC). This advisor clearly reduced the contracting costs in the Avalanche trade sale exit.

When the portfolio company in the Sabre case was approached by a potential acquirer from another continent, the founders were becoming increasingly concerned about the consequences a sale would have, something the acquirer noticed. This led the Sabre VC to engage an advisor:

> And so having him [the advisor] get involved was a signal to the potential buyer that we were serious about selling – at which they weren't sure of, because of the way the founders were reacting. And, so we sent a clear signal that we wanted to sell the company. We also sent a very clear signal that we weren't going to give the company away.

As the quote shows, the engagement of an advisor created an image of credibility towards the potential acquirer, which in turn made the relation between the parties more professional.

The two final factors found is related to the two different types of a company sale: auction and negotiated sale. As revealed in the literature review, these two distinct types of sales put different demands on the company for sale. This is also evident in the empirical findings, where an advisor performs different tasks dependent on the sales type.

Create and Facilitate an Auction

As many as 13 of the interviewees emphasize the role a financial advisor plays in an auction as an important rationale for hiring such an advisor. An example of this can be found in the Bruin case: "We engaged a team, a small company, … specialized in M&A, in order to create some competition for our case" (Bruin CEO/founder). For the Oiler CEO, this was also the rationale for hiring an advisor: "… we thought that maybe an intermediary might be able to bring some different potential buyers to the table, that we might not have relationships with."

However, the advisor is not always able to get new people to the table, which was the case in the Oiler exit process: "That [bringing new people to the table], unfortunately, turned out not to be the case. Everybody who came to the table were people we already knew and had relationships with." (Oiler CEO). This led him to terminate the relationship with the advisor, and facilitate the remaining part of the process internally. And, related to this point, the advisor might get new people to the table, but not the right ones. In the Penguin case, in-depth presentations were held with several players where the contact was initiated by the advisor, but in the end, the company was sold to an actor that was not contacted by the banker, not even in the initial phase.

In addition to identifying and getting potential acquirers to the table, an advisor can help with facilitation of the auction and negotiations. Financial advisors are deal savvy, and are specialized in performing such processes, something that our informants appreciate.

Another evident finding on auctions from the empirical data is that the actual process is in line with the process described in the theoretical background in section II. The Coyote VC describes the auction process in this way: "It is teaser, NDA [Non-Disclosure Agreement], IM [Information Memorandum], bid; then management presentations, due diligence, and final bid." Evidence from several of the other cases also supports this finding.

Facilitate Negotiated Sales

The VCs who were involved in negotiated sales and at the same time hired a financial advisor had the same rationale for this: namely to have a third-party facilitate the negotiation. As one of them stated: "So we hired him as an advisor and consultant, to help us shape [the deal] and negotiate for us, essentially" (Thrasher VC). The Lightning VC emphasizes the attention to detail and experience when explaining his motivation for hiring an advisor: "[They are helpful] to get things in place, and as a matter of fact, the devil is in the details. They have a lot of experience in these processes, and are able to unburden [us]." Again, this confirms the findings from the auction process: advisors can clearly be of assistance during negotiations and in the process of closing a deal.

Reasons for Not Hiring an Advisor

As mentioned in the methodology section, four out of the 19 companies covered did not engage an advisor. In order to give a more balanced view of the decision to hire an advisor, we will present these companies' view on this decision. When analyzing these four cases, three different factors emerged from the data. Appendix 2 gives an overview of these factors. The factors are elaborated on below.

Company/VC Knows Buyer Universe and has Relevant Relations

As described in the literature review, one rationale for hiring an advisor is described as the better merger hypothesis. This hypothesis states that advisors are superior at matching buyers and targets, something the Canuck VC does not believe in. Instead, he proposes that the VC or the company itself should be superior to the advisor in identifying potential buyers: "So, we didn't need a banker or someone to say: 'Oh, did you think of these people?', because it's unlikely that a banker would know more about our business than we do." If this holds true, the motivation for hiring an advisor should diminish.

As an extension of this issue, advisors often have a network with specific players, a factor presented earlier as a motivation for hiring an advisor. However, if the portfolio company or the VCs have this network themselves, this motivation perishes. This was the case in Ranger: "We pay for the relations, but in this case, we had these ourselves" (Ranger VC).

No Time to Get Advisor up to Speed

M&A transactions are time- and energy-consuming, and it is regarded as important to complete the transaction in as short a time period as possible. This was determining for the Flame VC when evaluating whether to hire an advisor or not:

> … we talked about hiring an investment banker, and decided we didn't have time, and it would take too long to get them up to speed. If there was going to be an auction, we could probably make it happen ourselves, because we decided this was happening too fast for us to go to brand new people. It had to be people we already had some relationship with.

Not the Right Time for Exit

At the time when the Flame portfolio company got an unsolicited bid, the company was considered to be two to three years away from an exit by its investors. This led the investors to have an agnostic view on whether to sell the company or not. If the price was right, they would sell, but if not they would continue funding the company. In addition, the chairman of the board in the Flame case had previously been an investment banker, and was able to facilitate the negotiations. Therefore, the investors found it unnecessary to engage an advisor.

Factors Affecting the Choice of Advisors

In this section, we will present findings from our study to shed light on the second research question presented in the introduction: What factors determine the choice of a specific financial advisor? Based on the data from the cases investigated, eight factors emerged. These eight factors were: Industry Experience, Size of Advisory Firm, Prior Relations and Referrals, Ambitions, Terms, Human Fit, Team, Network and Geographical Coverage. Appendix 3 presents the factors influencing the choice of advisor in each case. In the following paragraphs we will show how these factors are applied in the different cases.

Industry Experience

As industry experience is mentioned as an important decision criteria in the literature (Chang et al., 2010), it may not be that surprising that this factor is the most frequently mentioned among the interviewees. In fact, it is mentioned in some way by all but one of the interviewees that represented firms who engaged an advisor. For the Avalanche VC, industry experience was the first priority when he was choosing an advisor: "Because he knew this segment very well. … He was just that banker for this market segment." A similar point is made by the Senator VC: "One of the reasons we hired them was that one of the guys had first-hand experience from the industry. So he knew the industry intimately."

It should therefore be beyond doubt that industry experience is likely to increase an advisor's chances of being chosen. On the other hand, lacking knowledge of the industry can disqualify an advisor from being engaged. In the words of one of our informants: "If you don't know anything about the product, about the market, about potential acquirers or customers, you are not chosen" (Hurricane VC).

Size of Advisory Firm

The size of advisory firm versus the size of the transaction is clearly a priority for many entrepreneurial ventures when selecting an advisor. Many of the large investment banks, both internationally and nationally, aim at facilitating transactions that are considerably larger than a typical trade sale of a venture-backed company. If such a company undertakes a venture capital-backed trade sale, and then receives a deal proposal from a large company whom it does, or wants to do, continuing business with, the venture capital deal may lose attention.

The Hurricane VC, who actually employed a larger investment bank, suffered from this problem: "They were of course very skilled, but there was a problem with lack of attention due to other deals. As a matter of fact, we have not used this advisor in any following transactions."

Due to this issue, a segment of smaller M&A boutiques has emerged as viable candidates for advising venture-backed trade sales. These firms often specialize in a few industries, and target deals that are more in line with the value in a typical venture capital transaction.

One of the Coyote VCs has made attention one of his top priorities when choosing advisor after experiencing a similar problem as the Hurricane VC:

> If you hire one of the big investment banks, and one of the large companies are going to conduct an acquisition or a secondary offering, the whole team will prioritize that deal. This is a very unfortunate situation, and we have learned this lesson the hard way.

In the case of Coyote, an M&A boutique firm was hired partly because this firm was going to give the deal their top priority.

Prior Relations and Referrals

A prior relationship between the advisor and the investors is likely to have a positive influence on choosing that advisor. "Our relation with them was great, and we saw that this portfolio company was even more suited for the advisor [than the previous company sold with the help of this advisor]," the Bruin VC states. Prior relations were also an important factor for the Avalanche VC: "I had done prior business with him, both of … [the VCFs] … had done prior business with him, and the guy also knew the team." For the entrepreneur and CEO in the Islander case, investor relations is the only factor he puts forward when explaining the choice of advisor: "The venture guys had previous relations. The world, especially in Norway, is small, so relations to, and knowledge of, actors are very important."

The person or company chosen to represent the firm in a sales process does not necessarily need to have represented the company in such a process before. As the Sabre VC explains, they used an executive from a company that was previously in the VC's portfolio: "The intermediary we used was actually an individual who had been a successful CFO in one of our portfolio companies."

References from actors in the VCs' network are also found to be a relevant factor in the choice of advisor. The Star VC chose the advisor based on an introduction from his network. This relationship worked out well, and the Star VC has used the same advisor in later trade sales as well. The Penguin case gives another example of a referral influencing the choice of advisor: "Our chairman of the board [not a VC] had done business with this firm before, he knew them well, and knew that they were thorough and detail-oriented" (Penguin CEO).

Ambitions

Ambitions are clearly important when selecting an advisor. When an advisor is invited to pitch for a sale, it is expected to present a preliminary valuation. In order to maximize the effort made by advisors, some case companies have tied the compensation to this indicative valuation, for instance by offering the advisor a compensation package based on a sliding percentage scale. The Hurricane VC used this method:

> You are to a large degree able to find out what they [the advisors] think about the value by creating incentive structures. For instance, a deal that we did recently, was structured in the following way: one per cent of the value when the deal is under 100 million USD and two per cent of the deal value over 100 million USD. That means that it isn't really working out for the advisor before the sales value exceeds 150 million USD. If one potential advisor then says: 'In this case we need four per cent of the deal value,' you know that their ambitions are not that high. … And if your ambitions are low, you don't win the tender offer as an advisor.

However, according to the Blackhawk CEO, too high ambitions might in fact be interpreted as unrealistic by the principal. He invited three advisors to pitch for the assignment, one of whom they knew from before: "Interestingly enough, in the case of both of the others, we felt that they were being unrealistic, and trying to convince us that they'd get a really high number which we really didn't think was feasible" (Blackhawk CEO). This was one of the reasons that these two banks were not chosen for the assignment.

Terms

In addition to ambitions, the cost of engaging an advisor is relevant, as shown by one of the Coyote VCs, who explicitly states that he always looks at the price before choosing his agent. The cost was also relevant for the Blackhawk CEO, who managed to cut the deal cost by 75 % after bargaining with the preferred advisor. This was made possible because he already had identified the most likely buyers, and gotten these interested:

> So we approached them [the advisor] and said: 'We do like you guys, but we are also not prepared to pay your normal fee, because we have pretty much done most of your work for you.' So we ended up paying them a fee that was approximately 25 % of what they normally would get for a transaction like ours. In addition, we offered a success fee on the upside, which wasn't earned (Blackhawk CEO).

Although not disclosed in every case, it appears that contingent fees are widely used in the contracts between venture capital-backed companies and their advisors. In line with the theoretical proposal, a percentage of the deal value (constant or sliding) in addition to a (possible) fixed fee is the conventional incentive structure. The amount received by the advisor in each case was not disclosed during the interviews, and will therefore not be discussed.

Human Fit

As simple a thing as the personal fit between the principal and advisor can be determining for the choice. This is emphasized by the Lightning and Panther VCs as well as the Blackhawk CEO: "Both me and the VP of Finance liked this boutique investment banking firm, who we had kind of known before" (Blackhawk CEO).

The Coyote VC thinks that the personal relation between investors, management and advisor was an important success factor for the transaction outcome: "I believe that one of the reasons why the exit was so successful was that we engaged a competent advisor, who was skilled and worked well with the company, board, and us as investors."

Team

The actual team assigned by the advisor for the engagement is viewed as important by certain VCs. The VC in the Shark case views this as especially important, as shown by the following quote: "They [the advisor] were chosen due to their competence, … and their resources. And, in addition, which individuals they were going to assign to the engagement." Other informants also appreciate an experienced and knowledgeable team:

> If you show up [at the pitch] with two juniors that do not know anything about the product or the market, and deliver an average presentation, you know that these guys have not worked much on this (Hurricane VC).

Network and Geographical Coverage

An advisor might have a special relation to one or several prospective buyers. Such a relation is appreciated by target firms. With respect to the Thrasher case, a potential strategic buyer was contacted by the VC before the investment was made, in order to evaluate the acquiring interest. The potential acquirer confirmed its interest, and a year after the investment, the buyer approached the Thrasher VCF with an intention of acquiring the company. The Thrasher VCF then engaged an advisor that was closely related to the buyer. As the Thrasher VC notes:

> The advisor actually used to work for the strategic buyer. So he knew the company intimately that was going to be purchasing us. He knew what they were looking for, and the way they were going to structure the deal. So we hired him as an advisor and consultant, to help us shape [the deal] and negotiate for us, essentially.

The Thrasher VC believes that the choice of advisor was important for the outcome:

> Having known what the acquirers were looking for, and how they negotiate, it helped us to be able to go in and talk to the right people, and also go in with the right terms. And to focus on the right terms.

A similar point is made by the Blackhawk CEO. Some years before the actual acquisition happened, a boutique M&A firm had tried to acquire the Blackhawk portfolio company, working for European companies. This fact led to engaging this particular firm: "[We believed that] their contacts in Europe would be the right kinds of people to get involved in the bidding. In fact they were trying to acquire us in the past, so we invited them in to make a proposal" (Blackhawk CEO).

In addition to having ties to particular prospective buyers, geographical scope can be a point of differentiation for an advisor. As mentioned by one of the interviewees: "Most of the time, we use international bankers that specialize in working with relatively small companies, in a European context." (Senator VC).

In the Penguin case, its subsidiary located abroad was the most prospering. This led to choosing a foreign firm as advisor, the rationale being that the interest in the subsidiary's market was larger than in other countries. However, being especially focused on a single market can lead to excluding more likely buyers from other countries. Exactly this was the case in the Penguin trade sale, where the actual buyer turned out to be Norwegian. Nevertheless, this buyer was not contacted by the advisor during the process. In the words of the Penguin VC: "The focus on a sale to a Norwegian entity, and finding a potential acquirer or investor in Norway, was lacking." In fact, the sale was initiated by a random meeting between one of the VCs and the chairman of the acquiring company, not by the advisor.

We sum up this section by giving an overview of all the categories and cases. Table 2 shows the factors emphasized by the companies that hired an advisor.

Table 2 - Factors Affecting the Choice of Advisor

	Avalanche	Blackhawk	Bruin	Coyote	Hurricane	Islander	Lightning	Panther	Penguin	Sabre	Senator	Shark	Star	Thrasher
Industry	X	X	X	X	X		X	X	X	X	X	X	X	X
Size of Advisory Firm			X	X			X				X		X	
Relations	X		X	X	X	X			X	X	X		X	
Ambitions		X			X									
Terms		X		X										
Human Fit		X	X				X	X						
Team				X	X			X				X		
Network		X							X		X	X		X

Analysis and Discussion

In this section, we will address the two research questions individually, before we integrate the findings in a new framework that describes the advisor rationale and choice in venture capital trade sales.

Addressing Research Question 1: Rationale for Hiring an Advisor

When comparing the theoretical framework with the empirical data, a number of interesting insights can be drawn. The first insight is that the bargaining power hypothesis is supported by our data. Many informants appreciate the advisor's ability to create competition for the target, and this is the informants' main motivation for hiring an advisor when performing an auction. According to conventional competition theory, multiple buyers will increase the bargaining power of the seller, and thereby increase the sales price of the target.

Furthermore, the advisor's negotiation skills are perceived as valuable in a sales process, both when conducting an auction and facilitating a sale, a result clearly in line with the bargaining power hypothesis. The bad cop factor found is related to this issue: It is shown in several cases that the banker can extract the best possible terms, and at the same time avoid hurting the relation between the VC and the buyer. The life as a VC is a multi-round game when it comes to both investing and divesting, and to be on good terms with prospective partners or bidders for later portfolio companies is regarded as important.

Regarding the better merger hypothesis, our results are mixed. Only one VC mentioned that the advisor was able to find a buyer that was not on the radar and represented a special strategic fit. Several of the VCs did not think that the advisor had been able to create better mergers. Some cases show that although the advisor has been able to create competition by bringing more bidders to the table, they have not been able to attract the buyer that represented the largest strategic fit, the Penguin case being the most evident example. A possible explanation can be that VCs are industry specific (De Clercq et al., 2006; Fried and Hisrich, 1994; Tyebjee and Bruno, 1984). When doing deals in a specific domain, one gets to know the industry players and the dynamics of the industry. Thereby, a VC can be able to understand which companies that offer the best strategic fit for the portfolio company.

A couple of the informants hired an advisor to perform a valuation assessment, or a fairness opinion, as it is denoted in the literature. This finding confirms the suggestion offered by the literature; advisors may be engaged to perform an objective, third-party evaluation of the transaction.

Signaling credibility was also an explanation for why one was going to hire an advisor. The advisor will by involving himself in the transaction put his reputation at stake, and can thereby reduce the contracting costs between the parties. The contracting costs rationale is therefore supported by the data.

None of the informants mentioned explicitly the fact that an advisor might reduce the information asymmetry between the parties in a transaction. At first glance, this is somewhat surprising, because the information asymmetry is assumed to be larger when one of the parties is an entrepreneurial venture (Gompers and Xuan, 2009; Ragozzino and Reuer, 2007). However, as the sales process is described by the informants, the advisor creates and distributes teasers, information memorandums and data rooms, all elements that are supposed to reduce the information asymmetry between the parties. So, reduction of information asymmetry is clearly an important issue, and the data suggests that the advisor is hired to perform tasks that lead to reduction in the information asymmetry.

This leads us to another point put forward by the interviewees, namely to hire an advisor to do the job that is needed to complete a transaction: create marketing material, set up an auction (if relevant), and facilitate the negotiations and closing. As mentioned, entrepreneurial ventures are particularly resource-constrained, while VCs are notoriously in lack of time, so performing these tasks themselves could prevent them from doing more critical tasks. This is a point not mentioned by the literature to date. A possible explanation is that since the focus in the academic research has been on large and publicly traded companies, these companies are not as resource-constrained as an entrepreneurial venture. Therefore, they have the resources to perform these tasks internally without sacrificing other pressing issues.

Based on these similarities and differences between the literature and data, figure 2 gives an overview of the factors found to important from the literature review conducted in section II, as well as an updated figure showing factors found to be important from our data. The left column in the figure shows the factors found in the literature, while the right column is a framework developed for the venture capital trade sale exit perspective.

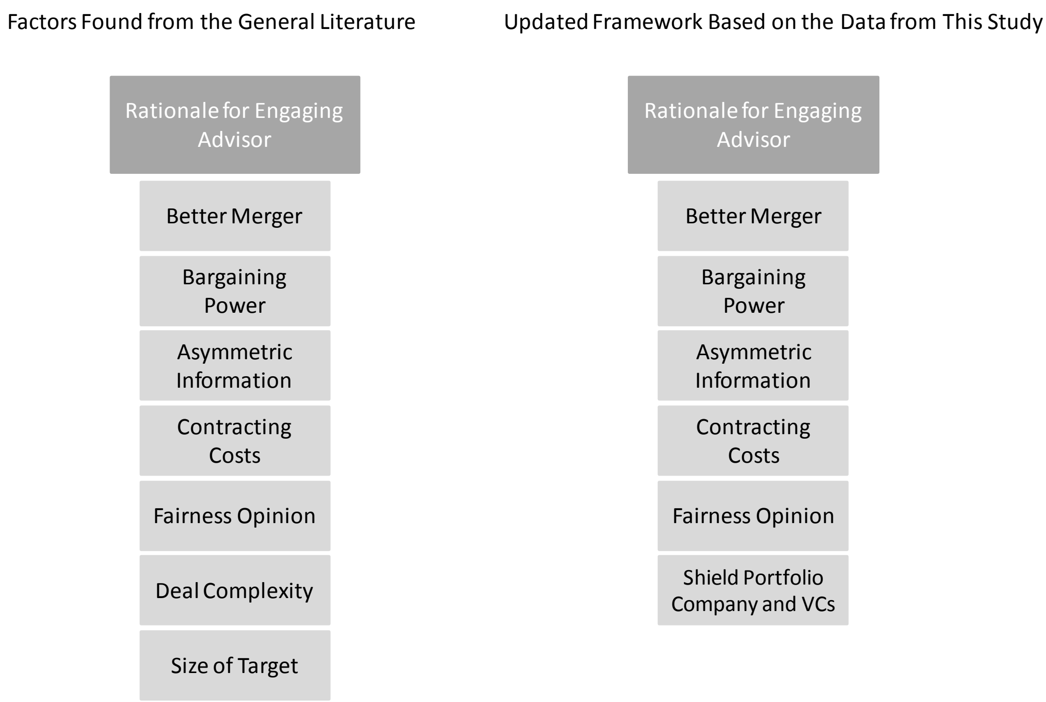

Figure 2 - Rationales for Hiring a Financial Advisor

As seen from this comparison, many of the factors are found to be valid both in the general case and in the trade sale exit process. We found no indication of deal complexity and size of the target affecting the decision to hire an advisor. At the same time, the shielding of the portfolio company and VCs was not put forward by the general literature, as discussed above.

Addressing Research Question 2: Factors Influencing the Choice of Advisor

The need for an advisor to be experienced and skilled in the target's industry is the factor put forward by most informants, and in line with the findings from Chang et al. (2010). In reality, this should go without saying: If one is to sell a company, it is clearly helpful to know the industry, the actors and the dynamics in the competitive environment.

Another finding that supports previous research is that prior relations enhance the possibility of being chosen. According to social embeddedness theory, this should come as no surprise, because a direct relation with an actor is preferred over information about this actor being reliable (Granovetter, 1985). Social relations in general play an important role in the venture capital industry, since the industry actors are tightly knit together in a network (Black and Gilson, 1998; Hochberg et al., 2007; Sahlman, 1990). A further confirmation of this is the use of references in the decision making among our informants.

Only one of the informants mentioned relations to the opposite party as a determining factor, a factor that was suggested as important from the literature. However, a closely related point is made by several others, namely that the advisor had done business with specific actors that were found to be highly interesting acquirers.

The closeness to the main bank is not mentioned by any of the interviewees. Venture capital-backed companies' capital structure consists mainly of equity, partly because lenders view such ventures as too risky. This means that the relation between the venture and its main bank is more peripheral than between the bank and a company that has taken on more debt, a possible explanation for this factor not being mentioned in the data.

In addition to those factors already found in the previous academic research, five new factors emerged from our data. The size of advisory firm was put forward as an issue by several informants, since large banks are considered as more likely to not pay enough attention to a typical venture capital trade sale. Related to this point, the team assigned is an important parameter when deciding whether or not to hire an advisor. This shows that VCs are very concerned with the commitment of the advisor. Moreover, the economic aspects of the relationship were found to be important. Both the terms offered, and the ambitions shown, could influence the choice. Finally, the personal relations between the VC, portfolio company, and the advisor were found to affect the choice.

The total of eight factors found in the data can be further grouped in two more abstract categories: advisor characteristics and network factors. Advisor characteristics are factors related to size and knowledge of the advisor, while network factors are categories that grasp the relational capabilities of the advisor. These categories are of course not independent. For instance, industry experience gained from doing numerous deals in a specific industry will of course extend this advisors' network, and maybe also give rise to a direct relation between the advisor itself and the VCs or management affiliated with the company that is going to be sold. Further, the size of the advisor may affect its geographical coverage, with larger banks probably covering greater areas than boutique firms. However, these two categories represent a natural distinction and abstraction.

Based on this comparison between the literature and data, figure 3 presents the factors found to influence the choice of advisors in venture capital-backed trade sales. The figure is separated in two columns, with the left column showing factors found to be important in the literature, and the right column showing the revised model for venture capital trade sales based on our data.

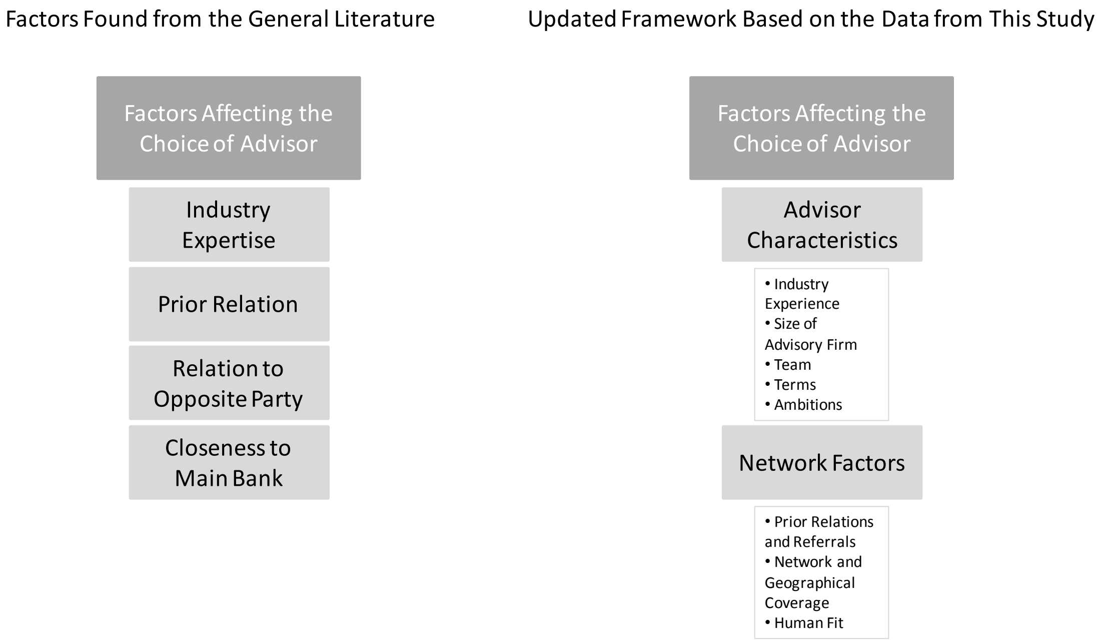

Figure 3 - Factors Affecting the Choice of a Financial Advisor

A Refined Theoretical Framework

After analyzing the findings in this study, it is clear that the theoretical framework developed in section II can be refined to be more suited to venture capital trade sales. The said framework consisted of three parts: the rationale for hiring an advisor, factors influencing the choice of a specific advisor and the roles played by an advisor in the sales process. As seen when addressing the two research questions, we have for both questions identified new factors that can tailor the model to venture capital trade sale exits. Further, the data suggests that the process when selling a company is in line with the process suggested in the theoretical framework, both for an auction and a negotiated sale.

Based on these findings, figure 4 presents the refined framework. This model is the first attempt to model the factors underlying the rationale for, and choice of, financial advisors in venture capital trade sale exits.

Several points regarding this model deserve further discussion. First, the data gives no right to conclude which parts of this model that comes first. As it is presented in figure 4, it is viewed as a linear process where one starts by figuring out if one needs an advisor, makes a choice, before the principal and the advisor agrees on the optimal sales process. However, the process can also be viewed in the opposite way, where an event (for instance an unsolicited offer) makes the target company choose between an auction and a negotiated sale, before it evaluates the need for an advisor, and then possibly engages one. The data has shown that both scenarios are realistic.

Further, with respect to both research questions, no claim can be made about which factors that are the most important when making the decisions. However, our data suggests that the bargaining power hypothesis is more evident than the better merger hypothesis with respect to the first research question. Regarding the second question, the interdependence between the factors is more relevant to put forward than trying to classify importance. As shown, the size and quality of the network is clearly important, but on the other hand, the team assigned and the motivation for the task are non-negligible factors. However, the factors are likely to influence each other, exemplified above with the relation between industry experience and network.

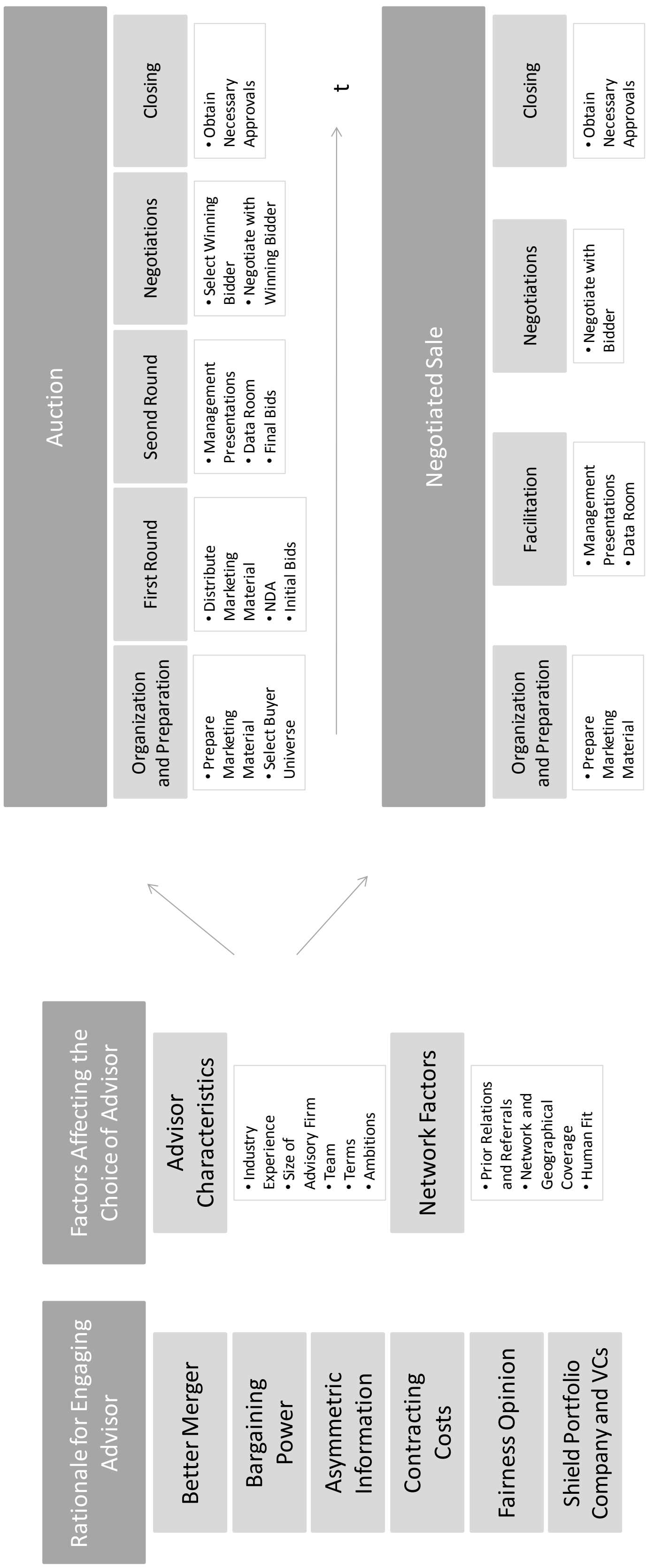

Figure 4 – The Choice and Role of Financial Advisors in Venture Capital Trade Sales

Conclusions and Implications

This paper started out by arguing that the choice of the target's advisor has been the scope of few studies compared to the acquirer's choice. Further, little attention has been given to sell-side dynamics in the M&A literature. Finally, no research has been done on the relation between VCs and financial advisors in trade sale exit processes. Therefore, the aim of this study was to open this black box, and examine the factors affecting the choice of engaging a financial advisor in a venture capital-backed trade sale. Accordingly, the following two research questions have been formulated: (1) Why do venture capital-backed companies engage financial advisors in trade sales, and (2) what factors influence the choice of a specific financial advisor?

In order to answers these questions, we have performed a multiple-case study covering 19 venture-backed companies in Norway and the U.S. that were acquired in the period 1996-2011. With respect to the first research question, we have added to the present knowledge by showing that VCs believe advisors are more valuable when participating in and facilitating deals, than when proposing prospective buyers. That means that our result is more in line with the bargaining power hypothesis than the better merger hypothesis. Further, we argue that since both a VC and an entrepreneur are participating in a multi-round game, an advisor can help maximize the deal proceedings through a bad cop role, while at the same time maintain a good relation between prospective buyers, the VC and the entrepreneur.

When analyzing the factors influencing the choice of advisor, we have found support for preceding research-based knowledge in that industry experience and prior relations and referrals enhance the possibility of being chosen. Moreover, we have in total identified eight factors that are found to influence the possibility for an advisor to be chosen. At last, we have integrated the findings from these two research questions in a refined framework, describing the venture capital trade sale process from initiation to closing.

Implications for Practitioners

There is no doubt that a venture capital-backed company has other demands than a larger, publicly traded company when facing an M&A transaction. It seems that many VCs are concerned about the advisor giving top attention to the case at hand, and therefore believe that so-called boutique M&A firms, specializing in M&A transactions, as well as in certain industries, are more likely to give top attention and assign experienced team members than larger investment banks. Unsurprisingly, experience through previous deal completion in the relevant industry, prior relations with the VCs or the portfolio company, and high confidence in the case enhances the possibility of being chosen.

Therefore, financial advisors aiming to advise venture capital-backed trade sales should put forward their best men, accept to be incentivized based on their indicative valuation assessment, and show proof of successfully selling similar companies to potential buyers in order to be assigned.

As for the VC and the portfolio company, some advice can be given with respect to the advisor decision. Some of the informants mentioned factors that have not been unveiled in previous studies, for instance the size of the advisory firm and the team assigned. This could be factors that VCs and portfolio companies should take into consideration before deciding what advisor to hire. Undoubtedly, attention from the advisor is important, and choosing an advisor that does not prioritize the venture capital trade sale can have severe wealth implications for the investors.

Implications for Further Research

As this is a study exploring factors that influence decision making with respect to engaging an advisor, we have no reason to claim which factors that are most important in deciding if to choose a financial advisor, and what factors that are most important when choosing a specific one. However, our refined theoretical framework suggests that the factors relevant for venture capital-backed companies are somewhat different than for companies in general. Further studies can therefore contribute to the literature by exploring what factors are the most important in venture capital trade sale exits when answering these two questions.

Moreover, as previous studies suggest, and this study confirms, the decision to hire an advisor is not trivial. A departing point with respect to this decision can therefore be if advisors are more often hired for venture capital-backed companies than for companies in general. However, as our data has shown, different VCs also have different attitudes towards said advisors. An extension of this issue could be if some archetypes of VCs are more likely to hire a financial advisor than others. Previous research in this field has suggested that such archetypes exist with respect to exit (Relander et al., 1994; Wall and Smith, 1997), so it is not unlikely that this also goes for the attitude towards, and use of, financial advisors.

As studies on the wealth effects of hiring an advisor are inconclusive, a study that explores the wealth effects of hiring an advisor in venture capital trade sales could be highly interesting. Further, such a study could unveil if some types of advisors are more successful than others. For instance, does an M&A boutique firm create more value than an individual or a larger investment bank? Similarly, the literature and our findings suggest two different types of trade sales; auction and negotiated sale. Two related questions that scholars could investigate are therefore: Through what kind of sale is a VC more likely to assign a banker, and in what sales type is the advisor able to create most value?

We have also found that an advisor can help eliminate potential incentive problems for an entrepreneur/top management member. However, it is yet to be explored if this actually is an issue. Is it likely that the entrepreneur will behave opportunistically in the closing of a trade sale process? Studies that explore the relationship between the investors, entrepreneurs and potential advisors during the exit process could shed light on this issue.

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Appendix 1 – Rationale for Hiring a Financial Advisor

Case	Type of Advisor	Type of Sale	Factors Identified
Avalanche	Investment Bank	Auction	**Create and Facilitate an Auction:** And you get an inbound interest. As a banker, that's easy, right. So there was no teaser, no nothing. Basically he just called six or seven people. **Signal of Credibility:** ...he [the advisor] was well respected by the acquirers too. He didn't come in with less attractive or challenged companies, he came in with good stuff.
Blackhawk	Boutique M&A Firm	Auction	**Create and Facilitate an Auction:** We invited the five companies who had been following us, but we also engaged an investment banker to bring other people in.
Bruin	Boutique M&A Firm	Auction	**Create and Facilitate an Auction:** We engaged a team, a small company, … specialized in M&A, in order to create some competition for our case. (E) **Bad Cop:** … when we started the negotiations, the advisor took the role as 'bad cops', which was a good thing. … The advisor had the lead role in the negotiations. This was a conscious choice, because if the transaction closed, I was going to work for the acquirer. It was better to take a back seat role than being the bad guy. (E) **Shield Portfolio Company and VCs:** It was the investment banker and us as investors that were in the front seat. (VC)
Canuck	No Advisor	Negotiated Sale	-
Coyote	Boutique M&A Firm	Auction	**Create and Facilitate an Auction:** We had to test the market and see if it was possible to sell. … We spent some time figuring out who the advisor should be. (VC1)
Flame	No Advisor	Auction	-
Flyer	No Advisor	Negotiated Sale	-

Case	Type of Advisor	Type of Sale	Factors Identified
Hurricane	Investment Bank	Auction	**Bad Cop:** In our experience, this is preferable [to engage an advisor], because … we don't want to destroy the relation to a possible buyer, we talk with these guys continuously, and a financial advisor can be somewhat more aggressive when approaching possible bidders. **Shield Portfolio Company and VCs:** There is a lot of work to be done: You are going to create a presentation, put up a data room, do a vendor due diligence, and we are not expected to do this. We are on the board of these companies, and this is not a board job. **Create and Facilitate an Auction:** We tested the market for other buyers when they came in. We wanted to know if other actors were possible buyers.
Islander	Investment Bank	Auction (terminated), then Negotiated Sale	**Create and Facilitate an Auction:** A prospect was created, and it was presented to different actors. We went to three or four actors.
Lightning	Investment Bank	Negotiated Sale	**Valuation Assessment:** We engaged an advisor in order to look at the offer, is this reasonable? Is it realistic to get a higher offer? **Facilitate Negotiation:** [They are helpful] to get things in place, and as a matter of fact, the devil is in the details. They have a lot of experience in these processes, and are able to unburden [us].

Case	Type of Advisor	Type of Sale	Factors Identified
Oiler	Investment Bank	Auction	**Create and Facilitate an Auction:** You know, I think the reason why we brought an intermediary on was probably two-fold. One is we thought that maybe an intermediary might be able to bring some different potential buyers to the table, that we might not have relationships with. That, unfortunately, turned out not to be the case. Everybody who came to the table were people we already knew and had relationships with. But that was part of it. **Valuation Assessment:** … [when] we first had a company make an offer to buy us, there was at least one investor who thought it was a bit premature to be selling. And so he was hopeful to get an outside banker's perspective on the market, and what people were paying, and what this company might be worth X years later as an IPO versus what we might be able to sell for today.
Panther	Investment Bank	Auction	**Create and Facilitate an Auction:** We decided to engage an advisor, something we typically do, to test if there was any interest for this case.
Penguin	Boutique M&A Firm	Auction (terminated), then Negotiated Sale	**Create and Facilitate an Auction:** Such companies typically create a teaser… And this teaser is then sent out to prospective buyers.
Ranger	No Advisor	Negotiated Sale	-

Case	Type of Advisor	Type of Sale	Factors Identified
Sabre	Consultant	Auction	**Create and Facilitate an Auction:** So when you're looking at exits and M&A exits – right, the only way to really get a good exit is to create an auction. Or at least the appearance of scarcity. … And, so we sent a clear signal that we wanted to sell the company. We also sent a very clear signal that we weren't going to give the company away. **Shield Portfolio Company and VCs:** They were getting very nervous about the relationship, they were very nervous about how the relationship was going, and the questions being asked and the way they were conducting due diligence. So, the decision was made fairly quickly to, as we call it here, circle the wagons. An old western term – right? And put an intermediary in place. **Bad Cop:** … when we or the intermediary had to play hardball with … the potential acquirer. … If you put the acquire in that situation, they're now arguing … with their future boss. … So, for me, the value of having an intermediary for that purpose was tremendous. **Signal of Credibility:** And so having him [the advisor] get involved was a signal to the potential buyer that we were serious about selling - at which they weren't sure of, because of the way the founders were reacting. And, so we sent a clear signal that we wanted to sell the company. We also sent a very clear signal that we weren't going to give the company away.
Senator	Boutique M&A Firm	Auction	**Create and Facilitate an Auction:** Yes, that [to create an auction] is an essential part. You have to create competition. The banker was in charge of handling the communication with the potential acquirers.
Shark	Investment Bank	Auction	**Create and Facilitate an Auction:** It was a full auction.

Case	Type of Advisor	Type of Sale	Factors Identified
Star	Boutique M&A Firm	Auction	**Create and Facilitate an Auction:** We hired a banker, and conducted a traditional process: we created a memorandum and contacted possible buyers. **Shield Portfolio Company and VCs:** In our experience the investment banker is a channel that can shield us, and position the company. **Bad Cop:** Yes, there was no doubt about that [banker being a bad cop].
Thrasher	Consultant	Negotiated Sale	**Facilitate Negotiation:** So we hired him as an advisor and consultant, to help us shape [the deal] and negotiate for us, essentially.

Appendix 2 – Rationale for Not Hiring a Financial Advisor

Case	Quote From Interviewees	Factor
Canuck	So, we didn't need a banker or someone to say 'Oh, did you think of these people?', because it's unlikely that a banker would know more about our business than we do.	Company/VC Knows Buyer Universe and Has Relevant Relations
Flame	… we talked about hiring an investment banker, and decided we didn't have time, and it would take too long to get them up to speed. If there was going to be an auction, we could probably make it happen ourselves, because we decided this was happening too fast for us to go to brand new people. It had to be people we already had some relationship with.	No Time to get Advisor Up to Speed
Flyer	Funny enough, we did not do that. And that was because we felt that strategically, the company was very well suited for the bidder. At the same time, it was a bit premature for an exit. Our main goal was to continue funding the company and then have a broad process. And we were just entertaining the buyer in this process, in case we would be offered a satisfactory price.	Not the Right Time for Exit
Ranger	We pay for the relations, but in this case, we had these ourselves.	Company/VC Knows Buyer Universe and Has Relevant Relations

Appendix 3 – Factors Affecting the Choice of Financial Advisor

Case	Quotes from Interviewees	Factors Identified
Avalanche	Because he knew this segment very well. I had done prior business with him, actually both of… [the VCFs]… had done prior business with him.	Industry Experience Prior Relations and Referrals
Blackhawk	It was one particular boutique investment firm that had tried to acquire us two or three times over the years, representing European companies. And, so we thought, number one, they understood us quite well … And that their contacts in Europe would be the right kinds of people to get involved in the bidding. We invited them both in [two other banks] to make a proposal as well. Interestingly enough, in the case of both of the others, we felt that they were being unrealistic [with respect to valuation]. Both myself and the VP of Finance liked this boutique investment banking firm, who we had kind of known before. So we approached them [the advisor] and said: 'We do like you guys, but we are also not prepared to pay your normal fee, because we have pretty much done most of your work for you.' So we ended up paying them a fee that was approximately 25 % of what they normally would get for a transaction like ours. In addition, we offered a success fee on the upside, which wasn't earned	Industry Experience Ambitions Network and Geographical Coverage Human Fit Terms
Bruin	Our relation with them was great, and we saw that this portfolio company was even more suited for the advisor [than the previous company sold with the help of this advisor]. (VC) … companies like Merrill Lynch would have been too large, they wouldn't fit us. (E) It was also a bit of personal relation, I met with them, and I liked them. (E)	Prior Relations and Referrals Industry Experience Size of Advisory Firm Human Fit
Canuck	-	-

Case	Quotes from Interviewees	Factors Identified
Coyote	And of course we had a reference from our co-investor covering this firm, so we felt comfortable with them being a good team. (VC1) The reason for choosing them before someone like Merrill Lynch or other large banks is that you are more certain of getting top attention. (VC1) … and that they have done transactions that are relevant for what we want to do. That is, sold comparable companies to comparable buyers. (VC2) And terms, what they want for completing the transaction. (VC2)	Prior Relations and Referrals Team Size of Advisory Firm Industry Experience Terms
Flame	-	-
Flyer	-	-
Hurricane	They are clearly a competent team. And if your ambitions are low, you don't win the tender offer as an advisor. If you don't know anything about the product, about the market, about potential acquirers, or customers, you are not chosen. If you show up [at the pitch] with two juniors that do not know anything about the product or the market, and deliver an average presentation, you know that these guys have not worked much on this.	Prior Relations and Referrals Ambitions Industry Experience Team
Islander	The venture guys had previous relations. The world, especially in Norway, is small, so relations and knowledge to actors are very important.	Prior Relations and Referrals
Lightning	… they had experience in this field, they are a large and well-known bank, and they had a good relation with the [portfolio] company.	Industry Experience Size of Advisory Firm Human Fit
Oiler	Not disclosed.	-
Panther	… and if we like the people, their experience and knowledge of the industry, and the team that they are likely to assign.	Human Fit Industry Experience Team

Case	Quotes from Interviewees	Factors Identified
Penguin	… this time it was a company in [a foreign country] that was engaged. The reason for this was that one of our foreign subsidiaries was successful and well-known. Our chairman of the board [not a VC] had done business with this firm before, he knew them well, and knew that they were thorough and detail-oriented. They had sold IT companies for many years, so they knew their stuff	Network and Geographical Coverage Prior Relations and Referrals Industry Experience
Ranger	-	-
Sabre	The intermediary we used, actually, was an individual, who had been a successful CFO in another one of our portfolio companies. He had done the process; he had a track-record of success.	Prior Relations and Referrals Industry Experience
Senator	I had a previous relation with [the advisor], as I had used them before. That's part of why we chose them. One of the reasons we hired them was that one of the guys had first-hand experience from the industry. So he knew the industry intimately. Most of the time, we use international bankers that specialize in working with relatively small companies, in a European context.	Prior Relations and Referrals Industry Experience Size of Advisory Firm Network and Geographical Coverage
Shark	They [the advisor] were chosen due to their competence … and their resources. And, in addition, which individuals they were going to assign to the engagement.	Industry Experience Network and Geographical Coverage Team
Star	… an introduction from our network in the US. It is these two things [that count]: domain expertise, that is knowledge of the specific market, and that the size of the deal is typical for them.	Prior Relations and Referrals Industry Experience Size of Advisory Firm
Thrasher	… [he] actually used to work for the strategic buyer. And, so he knew the company intimately that was going to be purchasing us.	Industry Experience Network and Geographical Coverage