UNIVERSITY OF LJUBLJANA
FACULTY OF ECONOMICS

MASTER’S THESIS

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NON-FINANCIAL ROLE OF VENTURE CAPITAL FIRMS IN STARTUP COMPANIES – COMPARISON BETWEEN TWO MARKETS

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INTRODUCTION

Entrepreneurs come in all sizes and are known to be the lifeblood of the nation, key to the improvement of many countries' economies. They are important for productivity, innovation, and employment, and play an impactful role in economic dynamism, especially during the recession period (Rachel's Angels Trust, 2013). Nowadays, the important step for the success of entrepreneurs, particularly in the early stages of development, is securing capital (Tesreau, 2001). Entrepreneurs can choose debt financing via financial institutions, research program grants (e.g. Small Business Administration business innovation research program), or by numerous state, regional, and minority grant opportunities (Cassar, 2002). The other way is to choose equity financing through crowdsourcing or through private and institutional investors in exchange for an equity or ownership stake, such as friends and family, angel investors, venture capitalists (hereinafter: VCs) and strategic investors (StartupNation Writer, 2005).

This master's thesis contains research and analysis that focuses on venture capital (hereinafter: VC) investments to fast-growing startups; and how they interact with their portfolio firms and how this adds value. For a deeper understanding of VC business, this research also focuses on firms located in different environments because I am interested in how the VC market is well-developed in some countries, but comparatively small in others (Gregoriou, Kooli, & Kraeussl, 2006). For example, some countries have more experience in the VC business due to more mature industries, whereas other countries are relatively new but less developed (Brinckhaus, 2011). The thesis explains how these points differ and the importance of gaining experiences in the business of VC.

I am currently working for a startup company that is closely related to VC business. Our company's success is tightly connected to the influence of VC firms involved. My direct experience has brought curiosity to start thinking about the topic on a broader scale.

Purpose and Objectives. Literature shows that VC firms are not present just for feeding small startup firms with fresh capital, but they also fuel the growth and development of entrepreneurs (Davila, Foster, & Gupta, 2002; Luukkonen & Maunula, 2007; Croce, Martí, & Murtinu, 2012). The box of services provided, besides money, is also important and it is acknowledged as a main contributor toward the startup's professionalism (Petreski, 2006). Thus, the main purpose of this study is to analyze what other skills VCs bring to startups in order to trigger, maintain, and speed up small enterprise growth. The main objective was to research differences in VCs' non-financial role between two markets and try to discover if experiences in the business of venturing are important in effecting firms that are VC-backed. To make these assumptions, I took into consideration well and less developed capital markets. To make a strong comparison between them I included an analysis of American VCs, which in this case represent a well-developed market; and Slovenian VCs, which represent a less developed market.

Thesis Research Questions. What kind of differences exist in VCs' non-financial role between Slovenian and US market? What are the sources of these differences and their implications?

Methodology. The thesis provides key concepts and problems relating to the analyzed field. Using a descriptive approach, I examined literature from different fields to cover the entire topic. I began with the importance of overall entrepreneurship in the economy and continued with financial options that entrepreneurs can choose to finance their businesses. This is followed by an introduction to the overall importance of VC firms, which segues to the main topic, expanding to a detailed analysis of non-financial value of VC firms brought to startups. Finally, I presented an examination of literature that relates to the topic of differences between less developed and well developed VC markets. I also used an exploratory research approach to help the reader gain an increased understanding of the meaning of VC investment to small startup companies by presenting both sides: the investor's and investee's, as well as to give a deeper view of the differences between markets where VC firms are located.

Structure of thesis. The master thesis is divided into three parts:

1. The first part consists of two (2) chapters, which are focused on secondary literature gathered on VC business. The first chapter consists of reasons why to choose VC over other financial options. The second chapter focuses on non-financial value added that VCs provide to their portfolio companies.

2. Value creation exists when considering VC investments, but not in equal amounts when considering different VC markets. In the second part, I described differences in the value added activities performed in well developed and less developed VC markets. Each is presented separately and with an emphasis on the main differences. These findings serve as a basis for the exploratory research that I conducted.

3. In the third part, the analysis of interviews is presented to verify all the findings from previous chapters. The primary role was to conduct in-depth exploration and differences of VC value creation in these two markets. The secondary goal was to acknowledge what kind of value creation exists and to present differences regarding the value creation in these two regions in relation to their portfolio firms. To foreshadow the conclusion, VCs in the US market appear to have a bigger influence in value creation and are effecting the business of their portfolio firms much more in comparison to Slovenian VCs.

Limitations. The first limitation of this master thesis is that I was not able to analyze the US VC market with the same depth as Slovenian. Furthmore, I was oriented on two specific markets but took them as an example of less and well developed VC markets. It would be beneficial to conduct research and in-depth interviews with other VCs, especially those situated in Europe to actually see where US VC business stands in comparison. It would also be beneficial to see where problems arise in which Slovenian VCs are not able to go further and develop this business to become a little more supportive to firms (in case of money and other non financial help).

1 VENTURE CAPITAL BUSINESS

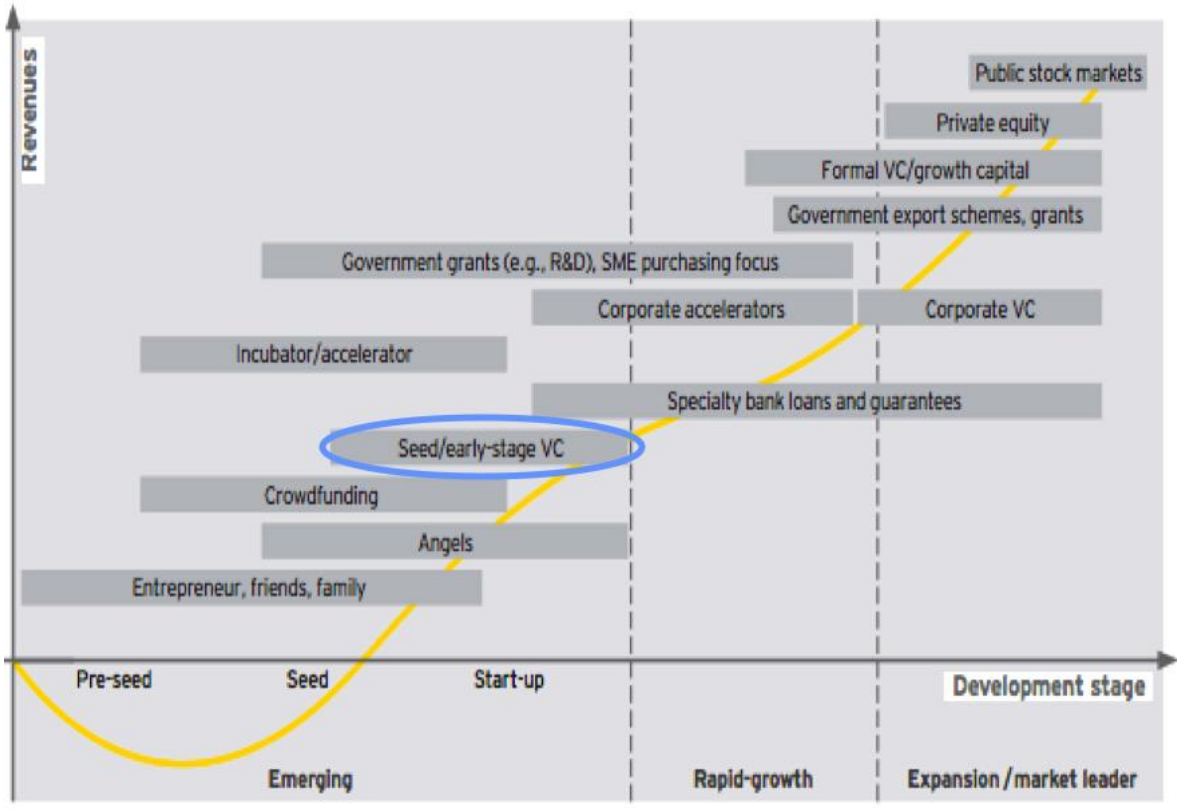
1.1 Investment options for startups

Financial capital is one of the necessary resources that companies need to sucessfully operate (Cassar, 2002).

Startup companies can choose debt financing via financial institutions, grants by research programs (e.g. Small Business Administration business innovation research program) or by numerous state, regional and minority grant opportunities (Cassar, 2002). In the early stages of high-risk businesses, companies need a factor to represent an important funding bridge to expand rapidly. Nowadays, the economy is passing by a very challenging time and both banks and the funds created by the government are reluctant to lend money to startups and small businesses. In fact, such kind of lending is of a high-risk nature given that both have little-to-no everyday involvement in the companies to which they lend money.

The other way is to choose equity financing by private or institutional investors in exchange for an equity or ownership stake - friends and family, angel investors, VCs and strategic investors (StartupNation Writer, 2005). Choosing between an angel investor and a VC has some differences when it comes to selecting candidates. Angel investors provide seed funds to startup firms and are mostly taking more risk by investing in a brand new firm, while VCs preferably invest in the more mature stage when the startup is already off the ground, which shows the fast growth of business (Peavler, 2014). The graph below shows the sources of fundings depending on a company's lifecycle that I described above:

Figure 1. Funding entrepreneurial business at different stages of development



Source: EY, Adapting and evolving, Global venturecapital insights and trends, 2014.

Fugure above shows that there are many ways to get funding but it depends on the Company's stage of development. Venture capitalists comes in front at a startup stage and just before startup tries to achieve the next stage which is the rapid growth. At that point venture capitalists with their experiences and knowledge can make a difference with the development of a company.

1.2 Advantages of choosing venture capital investments

VC is defined as independent, professionally managed, dedicated pools of capital that focus on equity or equity-linked investments in privately held, high-growth companies and closely follow the technology and market developments in their area of expertise in order to be able to make informed investment decisions (Spierings, 2011). No matter the challenges in the last few years due to the uncertain exit environment and associated fundraising trails, VC is still one of the best options to fund the early and scale-up stages for innovators. They continue to play a central role in the growth of many high-impact entrepreneurs (Endeavor Initiative Inc., 2012).

The process can be presented in five steps, which are (1) establishing funds, (2) deal flow, (3) investment decision, (4) business development and value adding, and (5) exit. Table below is describing what each steps reperesnts. This master thesis is focusing on the step 4 described as business development and value adding and it means sharing knowledge and expertice with the company they dicide to invest into.

Table 1. The venture capital process

1. step	2. step	3. step	4. step	5. step
ESTABLISHED FUND	DEAL FLOW	INVESTMENT DECISION	**BUSINESS DEVELOPMENT AND VALUE ADDING**	EXIT
Raise capital for investment	Find new ventures to invest in	Evaluate ventures and evaluate deals	**Knowledge and expertise and access to contracts**	IPO, Trade sale, secondary sale, buyback or MBO, Bankruptcy

Source: I. Pettersson & M. Öun, Critical Factors for Successful Strategy Formation in Venture Capital Funded Companies, 2012.

VCs are available in only selected candidates for their funding (VentureDen, 2012). It is a potent formula that fast tracks ideas and products to the market by financial investing and by training, motivating and creating the most favorable conditions for them to succeed (Berglund, 2011). VCs, in short, are in the business of helping other businesses succeed and are especially important in high technology sectors, where uncertainties are great and ventures often require substantial financial support (Berglund, 2011). As the gatekeeper of this highly sought-after funding, a VC is someone in the business of providing financial capital - the lifeblood of a firm - and advisory assistance at every stage of development, giving access to a plethora of resources, from networks and contacts to monitoring and strategic guidance, including service as a board member (Ramsinghani, 2011). It is said that VC firms provide a boost of adrenaline for small startups (Petreski, 2006) and are considered by both academics and practitioners as the most suitable financing mode for entrepreneurial firms (Croce et al., 2012).

VC firms can be one of the drivers for the success of entrepreneurial firms because most investors are not capable to make well-informed investment decisions. This has spawned firms with specialized VCs whose expertise allows them to invest in risky ventures on behalf of financiers (Berglund, 2011). These firms are closely teamed up with entrepreneurs, who bring insights and direction and at times, act as guardrails for entrepreneurial energy and enthusiasm (Ramsinghani, 2011). Instead of financing upfront, they invest in stages, just so they can keep control with ongoing projects and manage their possible risks. Stage investment allows VCs to monitor the firm before they make refinancing decisions and therefore reduces losses from inefficient continuation (Cherif, 2008).

It is well known that VCs represent the financial fuel that kickstarted many great companies (Facebook, Microsoft, Google, Celtra…), but there is less familiarity with what VCs do once they sit on a company's board. It is important to mention what kind of support they provide to back up companies beyond financing and how they use their investment muscle to attract and win more capital and to help the company grow in the businesses they are involved in (Ramsinghani, 2011).

Some research shows that VC-backed firms grow faster, patent more, have higher productivity and are more likely to go public than non-VC-backed firms (Croce et al., 2012). Furthermore, the research paper entitled, **Venture Capital Financing and the Growth of Start-up Firms** (Davila et al., 2002), acknowledges the fact that VC-baked firms have higher average growth rates. Some statements from the paper support this fact (Davila et al., 2002):

- VCs make their own selection of startups, which have the potential for high growth and a management pursuing it.
- VCs take an active role in the board and in monitoring the evolution of the firm, as well as in structuring top managers' compensation.
- VCs bring a network of contacts with experienced infrastructure providers (accounting firms, law firms and executive search firms) and potential professional managers.
- VCs themselves bring a reputation effect that facilitates growth.

For a startup it is important to develop resources to properly launch and sustain its business. However, it is extremely difficult to compete with existing and well-established businesses. There are many ways to finance startups, but it is a hard decision which way to go. When acknowledging all the possible funding options at the beginning of a startup business, we get to the point where the role of business angels and VCs becomes important in financing (Cassar, 2002). We can see that startup firms are too small to be fed by public debt and equity markets and are associated with a significant level of uncertainty (Tag & Lerner, 2013); and consequently, these startups often seek VCs to be involved in their businesses and activities.

Startups give VCs an opportunity to share its revenue in order to obtain necessary funding and to benefit from the VCs experiences in finance and management (Cherif, 2008). It is important to mention that only few are selected as investment opportunities regarding the financial support and even fewer go on to build successful companies (VentureDen, 2012). Why is that? Before any contract is signed and before money is brought to the company, VCs spend much of their time evaluating business opportunities in the area when startups want to enter the market. The situation is observed from many different perspectives. That kind of research eliminates bad investments and with that, VCs evaluate and make sure the future value is going to be brought for them as well (Petreski, 2006).

In the following sections, I will go into more detail with the basic role that VC brings when it comes to financing small businesses. Besides its capital invested into it, VC firms bring much more value and are acknowledged as main contributors toward a firm's professionalism (Berglund, Hellstrom, & Sjolander, 2007).

1.3 Non-financial added value brought by venture capital firms

"A lot of VCs have a playbook of how they are going to add value. They end up in a Socratic mode - always asking for information - constantly probing and pushing but never turning around and saying, let me help you solve that problem." - Brad Feld, The Foundry Group (Ramsinghani, 2011)

VC investments are available for only selected candidates (entrepreneurs) for their funding. Candidates should be well-positioned to obtain the benefits from VCs due to privileged knowledge in selecting valuable ventures and the possession of complementary assets that enhance the value of their portfolio firms (Dushnitsky & Lenox, 2006). In short, VCs can support portfolio startups in many different ways, including giving advice and support, helping with professionalizing the management team, creating strategic alliances, or exercising corporate governance (Jackson III, Bates, & Bradford, 2011). They can also spur their companies' innovation (Bottazzi, Da Rin, & Hellmann, 2004). VCs contribute a readymade ecosystem of talent, alliances, and expertise for converting an idea into a viable business plan and then launching and scaling a business to prepare it for exit (DiGorgio & Harris, 2013).

1.3.1 Non-financial added value in pre-investment stage

First, I would like to point out that creating non-financial added value begins with pre-investment action, especially with the early stage companies (Luukkonen & Maunela, 2007). VCs want to select the most promising investment and ventures among a vast number of investment proposals (Croce et al., 2012). This is the so-called "screening function", which is done very conservatively. It includes several steps and is important to take into consideration when making the decision. They are mostly searching for attractive deals as potential investments, which they try to structure and negotiate. Those kinds of evaluations are done for companies that are going through that process and should be valuable to them. Why? A positive feedback from an investor can give companies a hint that they are moving in the right direction with their business. Negative feedback enables companies to learn about their decencies as an investment target (Luukkonen & Maunela, 2007).

Companies receive guidelines about how to continue with the idea and where they need to improve, to become more attractive in the eyes of the VC investors (Luukkonen & Maunela, 2007). It is important for companies to take the pre-investment screening process very seriously in order to gain and obtain financing from a VC. They should also fulfill investment criteria, which are connected to the investment strategy of a VC. The investment evaluation process is done by describing and summarizing individual analyses, such as market, technology, customer adoption, competition and management. One of the most common sources of uncertainty is management risk. Some research suggests that this problem is present in more than 60% of the sample investments (Strömberg & Kaplan, 2001). VC investments call for a varied skill set in a team: raising capital, sourcing investment opportunities, adding value as board members and leading exits. These skills are prefaced by entrepreneurial expertise, technological strengths and the ability to perceive future market trends and maintain an even keel in somewhat ambiguous and rough times (Ramsinghani, 2011).

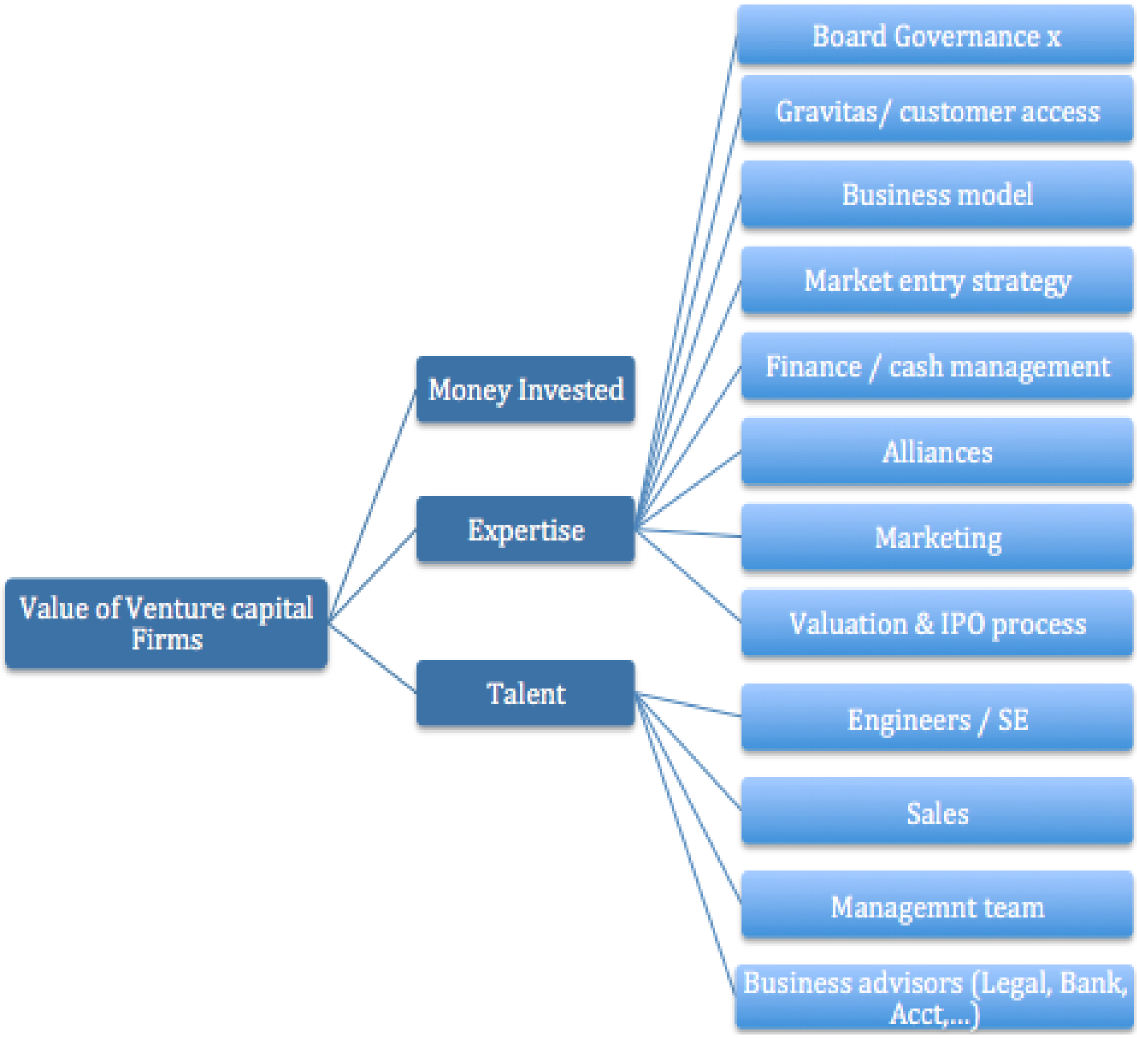
In the studies by Luukkonen & Maunala, the investment criteria are commonly built as a combination for the following: background and experience of founders, competence of management team, characteristics of markets and technology, and business plan. This combination is proven to be important for different VCs, which were examined in the study (Luukkonen & Maunela, 2007).

From all the above statements we can say that if a company develops its operations, business plan, or resources in order to make the company more attractive to VC firms, this development can be seen as the value creation being reached with the help of a VC (Luukkonen & Maunela, 2007).

1.3.2 Non-financial added value in the post-investment stage

VC firms are widely regarded as financial intermediaries that are not noted just as financial supporters, but also provide rich service packages who are known as innovation stimulators (Petreski, 2006). A good VC brings much more than money to the table. In fact, its contributions of connections, expertise and talent are just as critical as funding to the longterm success of any new venture (DiGorgio & Harris, 2013). These provided packages are more important for entrepreneurship as the every capital infused, in order to enhance its performance and its value (Petreski, 2006).

Figure 2. Value of Venture capital firms



Soure: C. DiGorgio & J. G. Harris, If venture capital falters, will job creation fade?, 2013.

In figure 2 we can see what kind of benefits VCs bring to the table once they invest in a company's business. Beside money invested, which is one of the important aspect they bring in some additional benefits which are expertice and talent. With the expertice they bring knowledge to the team and help them organizing a company's structure in a way to create a maximum success. With the third factor, mentioned as talent, VCs are trying to bring new people to the organization that would be beneficial to company's success. For a company that steps into relationship with a VC those factors are very important because withot VC's help some actions would be hard to implement.

I would like to emphasize that once the investor introduces its money into a business, he must devote much of his time in helping the business to succeed and build winners by providing portfolio firms with coaching, effective monitoring and valuable business contracts, by structuring appropriate internal organization and human resource management (Croce et al., 2012). By taking an equity stake in the company, VCs share the risks and rewards that are an integral part of growing a business — a real incentive to help these entrepreneurs make it to the next level (Endeavor Initiative Inc., 2012). The best VCs are fully committed to their startups for the long term and tend to be most promising young sprouts, until they are ready for harvest (DiGorgio & Harris, 2013). We have to acknowledge that every company has its own culture and are also facing different stages of development. When it comes to the money injections and involvement of VCs into the company's business we need to understand that value-adding activities are performed differently in each possible investment (Ramsinghani, 2011).

VCs have to adjust their knowledge and guidance specifically to a company's level in the development process. Some companies pursue truly innovative opportunities to the market and some plan to compete in already established industries. The studies showed that such companies have greater challenges to bring their product to the market and the greater strategic interests in being first to the market. Consequently, the effect of VC is strongest in this case (Hellmann & Puri, 2002). A good VC has a mix of sales, technical, human resources, financial and business strategy skills and has an ability to make rapid decisions in ambiguous, fast-changing environments (Ramsinghani, 2011). They have connections that open doors to potential customers and their commitment signals that a startup is a serious business with significant market potential (DiGorgio & Harris, 2013).

At the seed stage we have a founder and an opening - a white space in the market. It is defined as a place where a company might have room to maneuver in a crowded playing field. The VC needs to have the ability to understand risk, validate ideas and connect these to the market. Exploration and validation are key steps at this stage. As the company progresses, recruiting skills become essential. A startup is a no-name entity, which is why the credibility and track record of the VCs can be a tremendous asset in recruiting management talent. Such talent is usually in high demand and otherwise would not be available to a startup. In the early stage, a VC's ability to help the startup find customers is very important, and as the company evolves further, the ability to syndicate the investment becomes critical. Adding value to the company is a big challenge. Successful VCs extend value creation into the community and beyond (Ramsinghani, 2011). However, different articles adding non-financial value is described differently.

The research study by Henrik Berglund (Berglund, 2011) describes that VCs appear to fulfill three roles to their portfolio firms. They are found to serve as investors, coaches, and partners. In my research, a relevant role worth mentioning is when VCs act as coaches or partners because VC as an investor mostly concentrates on choosing good ventures to invest in. On the other hand, a VC as coach focuses more on building strong venture teams and continuously guiding and pushing entrepreneurs to develop their ventures. The VC as coach is more relevant in startups, which are operating under conditions of great uncertainty. Ventures adding value activities in the role of coaching are shaping the product categories, business models, and standards that will define future markets; they make sure the company is in a good position to succeed. VC as partner is described as an active contributor to the team's ongoing activities. The VC is therefore present in day-to-day operations and actively contributes and participates in many core activities.

Many studies explain that value added by VCs have strategic and operational dimensions and also depend on the stage of development, where a company stands (Boué, 2002). The study shows that in the early stage ventures, the weight attached to operational value is higher and it diminishes in expansion rate where strategic value added activities comes in front (Boué, 2002).

Table 2. Operational and strategic value added content by venture capitalists

Divisions	**Operational value added activities**	**Strategic value added activities**
Human Resources	Hiring and integration of general staff, negotiating salary of staff	Hiring of key staff, negotiation (technical & management)
Financing / Taxes / Controlling / Accounting	Budgeting, investment calculation, liquidity management	Contacts to further financing sources
Marketing / PR / Sales	Provision of sales channels, pricing	Analysis of strategic business units, information on market development
Technology / R&D	–	Information of technical developments, contact to technology partner
Procurement	Help choosing suppliers	Contact to potential suppliers
Organization	–	Definition of principles of: - Corporate structure
Organization of structure Process organization	Definition of processes	Corporate governance
Management / Business Development	Internationalization (how), IPO / exit (how), M&A (how)	Internationalization (where / when), IPO / Exit (who / where / when), M&A (who/ when), corporate goals

Source: A. R. Boué, Value added from venture capital investors: What is it and how does it get into the venture?, 2002.

In the book entitled, **Companion to Venture Capital,** Roberta Dessi contributed her research on "VCs, monitoring, and advising" where it is mentioned that addition to the primary role – financing – VC firms can provide and perform two functions, monitoring and advising (Dessi, 2009).

The advising function as an added value could be connected to a variety of activities, such as helping to recruit and compensate key individuals (management recruits), working with suppliers and customers, being active in development of business strategies, and serving as a sounding board to the management team (Luukkonen & Maunela, 2007). There are innumerable factors in determining weather or not a company succeeds, but none is as important as the role of the VC serving as a board member. A more engaged and flexible board member, ready to embrace and see opportunities in the challenges of a growing business can be an asset to the firm (Ramsinghani, 2011).

Being a member of the board of directors is regarded as a pivotal means of providing advice to the portfolio company and ensuring that its managers fulfill their obligations and follow advice (Luukkonen & Maunela, 2007). Through board seats and frequent interaction, they offer seasoned and tempered strategic advice on organizational planning and compensation structures to young companies in areas such as expansion, production, marketing, and selection of key executive personnel (Endeavor Initiative Inc., 2012). VCs can share their wide range of experiences in other portfolios to benefit the company. Besides value creation, the role of a board member is critical in assessing the performance of the CEO and helping identify and recruit other suitable members of the management team. It is important for a company's success that a culture of trust and open communication exists within the boardroom. If board members fail to communicate critical issues in between board meetings, these can lead to surprises, as well as inefficiencies (Ramsinghani, 2011).

I would like to point out here that there is much more then just a relationship inside of the board that matters. We can say that relationship can be built also informally - outside of the board. Informal cooperation may allow for easier exchange of information and it is also beneficial because it develops mutual understanding of each other's goal. It is argued that value adding of VCs outside of the board activities is the most important mechanism of VCs (Luukkonen & Maunela, 2007). Extending time devoted to the portfolio company in which VC is a part of, is also related in value creation in the firm (Luukkonen & Maunela, 2007). Frequent intrecation between VC and entrepreneur enchanses access to each other's knowledge base and increases the capability of processing complex knowledge. This brings to more favourable investment options. A noted fact important to observe is that lead VC investors visit each portfolio company on an average of 19 times per year, and spend 100 hours in direct contact (onsite or by phone) with the company (Dessi, 2009). Being often in contact with their companies and receiving a sufficient knowledge of the industry, VCs play a very active role in negotiating with suppliers, helping to recruit and compensate key individuals, replacing founders, outside CEOs, providing strategic advice and access to consultants, investment bankers, and lawyers (Dessi, 2009). For any portfolio company, VCs should have an understanding of the company's competitive position in the industry to help them stay nimble and to make inroads in the market.

VCs are expected to keep abreast of specific industry developments, as well as the current regulatory environment to maintain oversight of rules and regulations and to understand the government's requirements throughout the development of the company (Ramsinghani, 2011). VCs are inclined to specialize not only by the stage of investment, because that kind of specializing depends its understanding of, and experience in, the industry in which venture operates (Spierings, 2011). VCs' richness of expertise, competencies, experience, and reputation are important for a firm's promoter and consultant. VCs create value by providing networks, moral support, general business knowledge and discipline (Petreski, 2006). No other profession offers as great combination of intellectual stimulation, financial gain, freedom/autonomy, and the thrill of building companies. The business of VC is an intellectually demanding, adrenalin-laden career path (Ramsinghani, 2011).

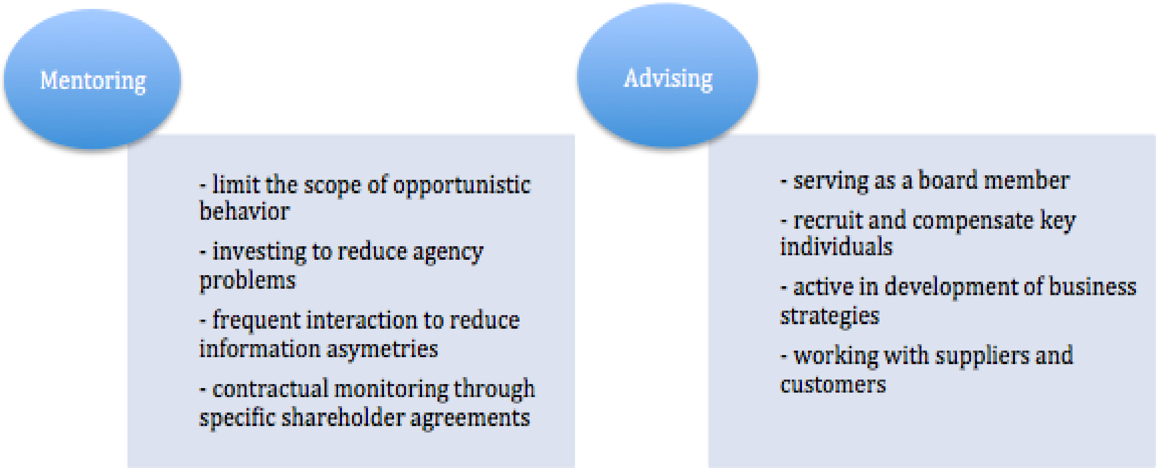
Monitoring, on the other hand, enables VCs to limit the scope of opportunistic behavior by the entrepreneur (Dessi, 2009). Investee activities and actions are closely monitored by VCs prior to investing to reduce agency problems (Spierings, 2011). The monitoring process starts with mechanisms used by VCs, for example, through contractual agreements, financial reporting systems, monitoring financial performance, obtaining financing and having one or more representative on the Board of Directors (Luukkonen & Maunela, 2007).

Involvement in the business itself and the agency risks implies greater involvement in terms of control. VCs as financiers typically develop detailed monitoring mechanisms. As shareholders, they develop contractual monitoring through specific shareholder agreements as well as through differentiated shareholder rights (Berghe & Lavrau, 2001). Moreover, they play monitoring roles as board members and through their (intense) relationship with management. Post-investment monitoring often requires frequent interaction between VCs and venture-backed companies. This is very important for a company's success because if they fail at communicating, these can lead to inefficiencies and other possible problems (Ramsinghani, 2011). With monitoring, VCs reduce the information asymmetries and financial risk. They are active investors whose monitoring function enables them to keep a track of what is happening in the company and in addition to that, play a significant role in influencing further financing (Berghe & Lavrau, 2001).

VC firms bring managerial expertise and specialized industry know-how to the companies they invest in. They can improve the management information systems and enhance the corporate governance of investee companies and introduce performance-based incentives. Private equity managers tend to have a more hands-on management approach providing extensive value-added post investment support (EVCA, 2013).

We can say that the monitoring function is a huge benefit brought to companies from VCs that help businesses to succeed. It significantly influences the professionalism of startups and minimizes the potential agency costs (Spierings, 2011). Due to international experience, a VC can judge the success or failure of similar scenarios. VCs can also develop a professional monitoring system by installing formal information flows. It is important to emphasize that monitoring role prevents the venture from making professional mistakes (Berghe & Lavrau, 2001).

Figure 3. Monitoring and advising role of VC investor



Source: Dessi, R., Venture capitalists, Monitoring and Advising, 2009

1.3.3 Differences in the value added by venture capital firms

Above, I mostly described how VCs in general add value, but as an addition to this point, I have to emphasize that VCs should not be treated homogeneously when discussing value added to portfolio companies. VCs are a heterogeneous group and each entity has its own mission and objectives (Luukkonen & Maunula, 2007). Some investments are strategically oriented, which means they are primarily made to increase the sales of a corporation's own business and have a mission of creating new jobs or developing new technologies. Strategic investments seek to identify and exploit synergies between itself and a new venture. The other investment objective is financial, and a company in that case, is mainly looking for attractive returns (Chesbrough, 2002).

Besides VC firms and their different missions and objectives, it is also important to point out a presence of VCs who lack experience in the market. A VC's experience can greatly impact and extend how helpful they can be to the value adding process (Liu, 2009). A VC's standing in its industry in terms of experience, visibility, and depth of funding strength are important. Value added obtained by companies backed by more experienced VCs comes from the advisory and intermediation services provided, as well as from the expected higher quality underwriting activities (Yap, 2009). VCs with more experience in the ventures industry can be more helpful unlike VCs without industry experience (Liu, 2009). These significant effects are important for the long-term operating performance and survivorship of the venture-backed company in the post IPO, if it appears.

1.3.4 Disadvantages of venture capital investments

While there are many advantages to VC funding, there are also some disadvantages connected with VC investments. As already mentioned in the discussion above, VCs tend to counter that part of the value they bring to professionalize the firm. This process may involve hiring the best possible management team, and as a consequence, it might happen that a founder could be replaced by an outsider in the position of CEO (Hellmann & Puri, 2002). The monitoring and advising role of VCs may also be detected as a disadvantage, mainly because VC-backed companies, in this case, give up key decisions on how to operate the business. Furthermore, management ownership may also increase incentives for them to work for the short term gain rather than long-term profit (Liu, 2009). VCs will require to be informed of any major decision that firms make and also have the power to override such decisions. As a consequence, there is a chance for creating internal problems (Martins, 2013) by withholding information, which is critical to the decision making of the capitalists, since they know better about the business itself (Liu, 2009).

If information asymmetries and agency costs do not exist, then VC would just provide the money and the entrepreneurs would decide whether to continue the project from their private information, but in most cases, entrepreneurs' private benefits do not result in shareholders' monetary returns. Therefore, mechanisms are driven by VCs to avoid adverse selection and to mitigate such kind of agent risks (Liu, 2009). Potential conflicts between investor and entrepreneur could be avoided with confident and trustworthy behavior, where the role of the entrepreneur and that of the VCs are going in the same direction (Petreski, 2006). All in all, even with presenting disadvantages we can assure that VCs provide value added services, help to professionalize companies they finance, and have an effect deeper down the organization - in human resource management - helping their companies establish themselves in the marketplace (Hellmann & Puri, 2002).

2 COMPARISON BETWEEN VENTURE CAPITAL MARKET IN SLOVENIA AND THE UNITED STATES

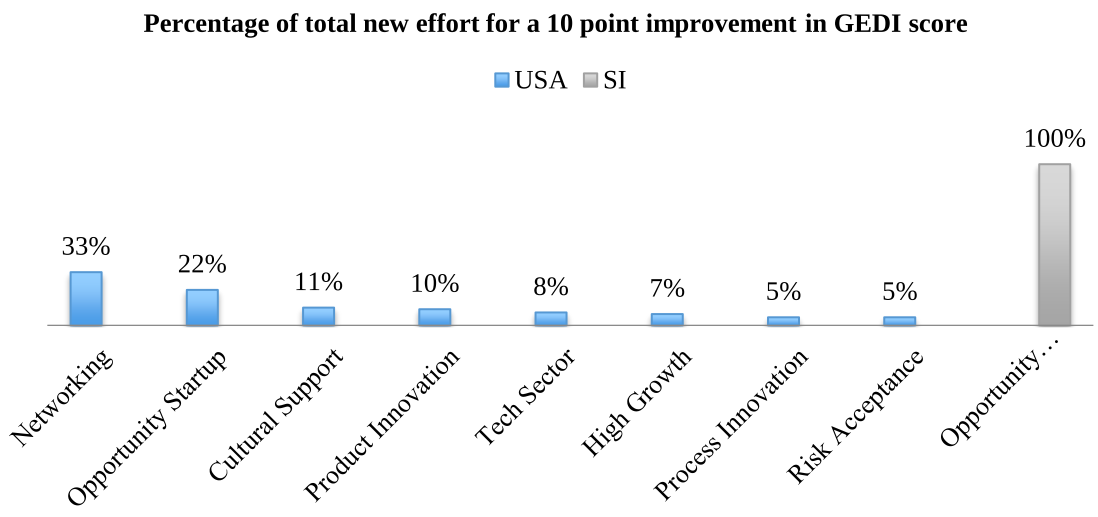
Entrepreneurship and new growth companies are the driving force of the VC industry and a stable flow of new startups ensures good investment opportunities for VCs. The rise of the VC industry makes fundraising for new growth companies easier (Lindström, 2006). Country specific factors in that case play a major role when discussing about how well and how much VC a company can attract (Gregoriou et al., 2006).

2.1 Entrepreneurship development in the United States and Slovenia

Entrepreneurship is a crucial engine of economic growth. To understand the true impact of entrepreneurship in the economy, we should look at the country's entrepreneurship ecosystem as a whole (GEDI, 2015). This sections explores the entrepreneurship development comparisons between the United States and Slovenia; while also highlighting the current state of entrepreneurship development in Slovenia.

When it comes to financing new businesses through VC, we can view the American market as a world and regional leader. It has been stated that entrepreneurship plays a crucial role in the US economy. A a result, policy initiatives have been or are regularly being created to encourage entrepreneurial behavior (Myers, 2014). The US is ranked as having the best access to funding by a significant margin, as well as the best entrepreneurship culture, which means that it tolerates risk and failure, prefers self employment, has an innovation and research culture, and celebrates self-made wealth to a greater extent than other countries (Nisen, 2013). On the other hand, the Global Entrepreneurship and Development Institute (hereinafter: GEDI) has put Slovenia in 29th place in the world rankings and in 19th place in the regional rankings in entrepreneurial ecosystem (GEDI, 2015).

Figure 4. Comparison between USA and Slovenian entrepreneurial in percentage of total new effort in each pillar for a 10 point improvement in GEDI score



Source: Global Entrepreneurship and Development Institute, Global enterprenourship index, 2015.

In the graph above, we can see that Slovenia has the chance to improve only in opportunity perception (GEDI, 2015), which is essential for recognizing and exploring novel business opportunities (Singer, Amoros, & Moska, 2014). However, this trend in Slovenia has declined – going from 20% of adults that perceived business opportunities in 2012 to 16% in 2013 (Rebernik & Jaklič, 2014). This trend in Slovenia shows a potential 'bottleneck' to entrepreneurship, therefore, exhibiting negative results on entrepreneurial activity and also on their financial support. This should be a priority aim for entrepreneurship policy. Slovenia also exhibits a low share of established entrepreneurs between 25 to 34 years old, which goes to just 7% (GEM Slovenija, 2013). The most successful entrepreneurial economies, as in this case represented by the US, are both broad and deep across most of the components in Graph 1 and have a chance to improve (Imperial Collage London, 2015).

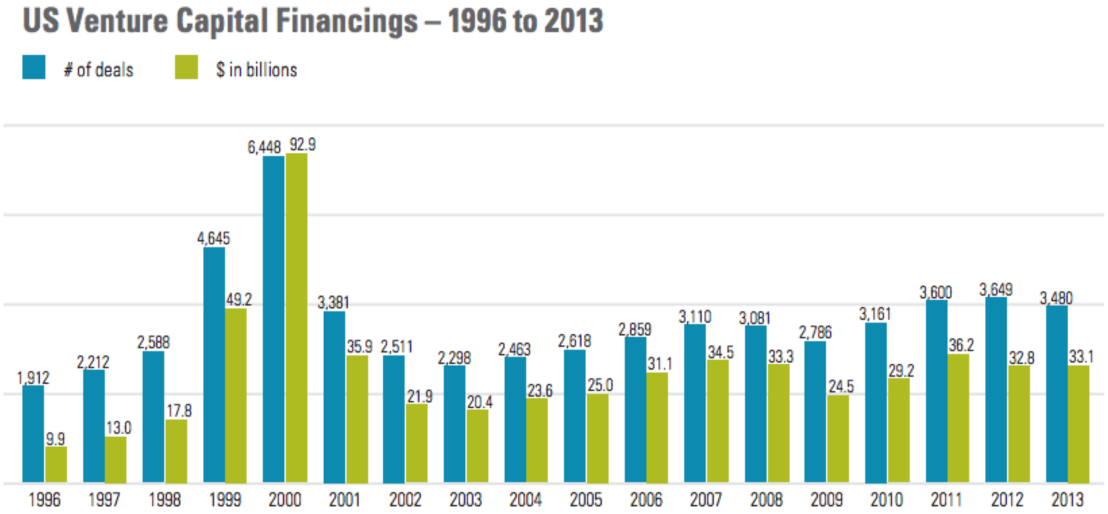
I should point out that governments play a crucial role both by creating the right funding ecosystem for entrepreneurs and startups, and in many cases, provide them with vital funding that complements private VC (EY, 2014).

“The governmental effect does not show directly. The most important and number one role of the Slovenian Government should be to create a friendly entrepreneurial environment for startups so it will allow them to develop ideas with less bureaucratic procedures that are for now a big obstacle for startups – I do not see our government as investors.” - Tatjana Zabasu, RSG Capital (27th roundtable at START-UP CAFE: Role of Investors in Slovenian entrepreneurial ecosystem)

2.2 Current situation on the United States venture capital market

On the geographic front, the US continues to lead the VC activity due to underlying structural advantages of a judicial, taxation, and regulatory environment peppered with innovation and an entrepreneurial mindset. The entrepreneurial drive combined with the set of market conditions is not easy to replicate, however. Creating a political environment combined with a strong legal infrastructure that speedily addresses corporate, shareholder, taxation, and intellectual property concerns in the foundation on which VC investments can be established (Ramsinghani, 2011) is a major factor. Entrepreneurship has been a primary engine for the US economy related to job growth and has been stable for over 30 years, beside the years of recession (Markovich, 2012). However, VC-backed companies were less effected by the crisis than other private companies. From 2008 to 2010, VC-backed companies’ employment fell 23% less than the overall decline of US economy and also while total US sales fell 1.4%, VC-backed company revenue grew at 1.5%, which outperformed their overall industries in 12 to 16 sectors (National Venture Capital Association, 2011). American financial markets are turning strong, from robust VC community to business angels, special banks, and the developing crowdfunding market, which together present a most favorable entrepreneurial environment (Clifford, 2013). VCs historically have been the most efficient creators of tech innovation and job growth. VC represents only 0.5% of total US research and development investment, but over the last 40 years, venture-baked companies produced $3 trillion in annual revenues, 21% of US GDP and 11% of the private-sector jobs (DiGorgio & Harris, 2013). The US business environment this year has strengthened and has become even better for VC firms. There was more money invested into VC business for support of startup companies to assure the most innovative young companies could access the capital they need to grow (US venture capital market 'healthy' and likely to improve, 2015).

Figure 5. US venture capital financings – 1996 to 2013



Source: Wilmer Cutler Pickering Hale and Dorr LLP, Attorney Advertising, 2014.

VC activity over the past few years shows a healthy and consistent appetite. It raised US$100 billion in finance and despite broadly stable VC pipelines, the angel and incubator funding and its proportion of overall investment have increased (EY, 2014). As we can see, the data shows that from 2007 the rate at startup stage in the US nearly doubled, from 13.7% to 25.5%, but their involvement in the revenue generation and profitable stages has remained in the single digits (EY, 2014). The US investments seed/startup companies represented 6.3% of GDP while later stage ventures represented 11.11% of GDP (OECD, 2014). For VC firms, investing early is critical. A $2 million investment at the outset of a venture typically buys 20% stake in the company – and may bring returns on investment, over 8 years or more, of up to 20 times that investment.

American VC has spurred the development of many high tech industries and those successes have made the US a magnet for the globe's best and brightest entrepreneurs (National Venture Capital Association, 2009). The high tech industry represents 39% of all corporate deals through Q1 2013 and the highest number of all acquisitions (NVCA and Ernest & Young, 2013). The US has created an environment with a supportive public policy; VC promises for providing efficient distribution of capital and expertise to the most promising ideas (National Venture Capital Association, 2009). Along with intellectual property, the linkages with VC and startup formation (Ramsinghani, 2011) remains one of the key ingredients for ongoing innovation.

VCs have helped create businesses worth billions of dollars, employing millions of people – especially in the world of high tech (DiGorgio & Harris, 2013). In the US, VCs play a leading role by persistently identifying and funding only those ideas with a transformative potential, and they've proven themselves to be the most effective mechanism for rapidly deploying capital to the most promising emerging technologies and industries. (National Venture Capital Association, 2011). In the future, VCs will want to broaden their impact by seeking out new industries for investment (DiGorgio & Harris, 2013).

2.3 Current situation in the Slovenian venture capital market

A vital role for the Slovenian economy are small and medium startups. Startups can be an appropriate way for Slovenians to realize the perspective that successful entrepreneurial ideas can create new job opportunities and have a positive effect on economic growth and GDP growth. But the first issue we have to point out is that the Slovenian entrepreneurial environment is not as supported as it should be to have any positive influence on economic factors – the general perception is growing, but there is still need for improvement.

"10 years ago the ecosystem was very undeveloped in comparison to nowadays. In my opinion, Slovenia supports the startup ecosystem well enough. You can gain access to experience, localy and from abroad, and you can gain a lot of knowledge – but still there is a place for improvement." Darko Putina, founder of a company Mimovrste (27th round table at START-UP CAFE: Role of Investors in Slovenian entrepreneurial ecosystem)

The provision of adequate financial resources thus represents one of the key barriers for better and faster development of the segment of small and medium-sized enterprises as compared to larger companies because of difficult access to external sources of financing. Funding that dominates in small and medium startup companies in Slovenia are still traditional debt finance instruments, therefore, the meaning and scope of VC remains relatively modest, both in absolute and relative terms (Vlada RS, 2007). The state of the VC market in Slovenia is not so bright when we search for the data about VC investments related to Slovenian GDP. Slovenia invested 0.004% of VC in comparison to its GDP and we are listed as one of the least developed countries concerning VC investments (European Comission, 2013).

According to data, the VC market in Slovenia is very poorly developed; the authority acts on VC companies, which were developed in 2007, which has done some work to improve the situation and make a bit of progress. In Slovenia's short independent history, VC business was not used as a choice for financing. Therefore, the market in Slovenia is very unattractive for potential investors because of disincentive taxation, investment policies, and as a consequence, investments by VCs were not frequently carried out (Erbežnik, 2010). This situation is still present now. Even though we recorded a slight rise of entrepreneurship activity from 2012 to 2013 (6.5% of new enterprises), the overall entrepreneurship in Slovenia still shows a downward trend in the perception of business opportunities (GEM Slovenija, 2013). According to GEM, the cultural and social norms are still unwilling to drive the entrepreneurship, which is negatively accepted in Slovenian society.

We can still feel the presence of negative perceptions about the reason to start a business in Slovenia. The major difference between the US and Slovenia, is that Slovenians usually start businesses to gain employment, but Americans start businesses with the idea to sell it in the future as an investment (Kastelic, 2013). It is necessary to change this perception and leave the existing patterns of thinking and behaving in Slovenia. The global environment is constantly changing and so should the Slovenian environment, including Slovenian people (Krapež, Škerlavaj, & Groznik, 2012).

"I think that we need some more stories of success that will bring positive effects. I think that way of thinking is still very behind and it needs to change." Tatjana Zabasu, RSG Capital (27th round table at START-UP CAFE: Role of Investors in Slovenian entrepreneurial ecosystem)

Slovenia lacks a primary network of investors who would be willing to invest their funds in early stage companies and help them to develop internally. However, VCs in Slovenia usually have absurd demands, such as 40% ownership of the invested company or a minimum of 1 million EUR (Ravbar, 2015).

Table 3. Operating venture capital firms in Slovenia

Venture capital firms that actively operates in Slovenia	**Amount invested in companies (in EUR)**
PRVI SKLAD (RSG KAPITAL), DTK d.o.o.	12.400.000,00
DTK MURKA (UD), DTK d.o.o.	3.900.000,00
META INGENIUM (META GROUP), DTK d.o.o.	2.900.000,00
STH VENTURES (S.T. HAMMER), DTK d.o.o.	3.900.000,00
SCS (MPE), DTK d.o.o.	250.000,00

Source: B. Kupec, Start-upe čaka še 18 milijonov tveganega kapitala, 2014.

Slovenian VCs cooperate in a public-private partnership with the state. With their investments in companies they participate in the strategic directions of growth and development and assist in all areas of business. From 2010 to 2014 in the mature stage, 23 high tech companies in Slovenia received support from VC firms, which is very little in comparison with the total number of startups (210), who were supported by the Slovenian Enterprise Fund in 2014 (Borštnik, 2014). Those companies have created 192 new job positions, but that number is expected to be higher (Eržen, 2015).

Table 4. Enterprise fund support to startup companies 2014

Total support of Enterprise fund to startup companies 2014 (up to 5 years of existence)		
In 2014, Slovenian Enterprise Fund supported 210 startup companies in total amount of 23,1 mil EUR		
% of 23.1 mil EUR	Amount in EUR	Out of 210 companies
56% warrants	13.0 mil EUR	70 backed companies
4% loans	0.9 mil EUR	39 backed companies
24% venture capital	5.54 mil EUR	6 backed companies
4% seed capital	1.0 mil EUR	20 backed companies
12% special incentives	2.7 mil EUR	75 backed companies

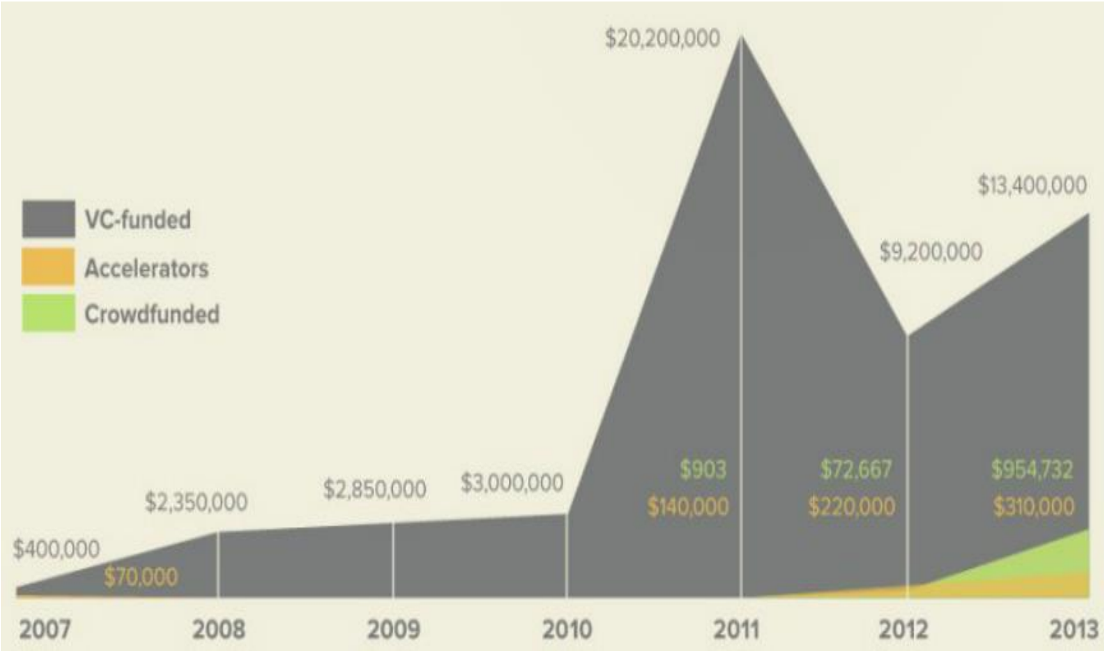
Source: Slovenski podjetniški sklad, Celovita podpora slovenskega podjetniškega sklada - ključ do uspeha slovenskih podjetij, 2014.

Investments are mostly done in companies involved in information/communication technologies, especially in development of mobile applications (Eržen, 2015). It is important for Slovenian VCs to orient themselves specifically toward those well-known technologies because they have a lot of experience when it comes to the existing knowledge.

Besides capital needs in startup companies, we are still recording a big demand on the side of already established companies struggling to survive, and trying to search for solutions for their debts. Those companies are trying to receive money from VC firms because they still see those investments as grants, which will assist them with financial problems (Erbežnik, 2010). This proves that entrepreneurs in Slovenia are not educated enough on the characteristics and possibilities of VC investments. Through time, not just reaching for VC, but also for access to seed capital will become an important factor for Slovenia because it is going to fill a gap in financing startups, and will hopefully prevent young entrepreneurs from leaving Slovenia (Slovenski podjetniški sklad, 2014).

“We are not supporters of investing in big companies which are struggling to survive and which are hiring the incapable employees – we do not need this to be present in Slovenian business so called “survival financial injections” will not bring nothing good back to the environment. If this happens the business model needs to change or company should close its doors and start with something new.” Darko Putina, founder of a company Mimovrste (27th round table at START-UP CAFE: Role of Investors in Slovenian entrepreneurial ecosystem)

Figure 6. Obtained resources for funding startups in Slovenia



Source: M. Rebernik & M. Jaklič, START:UP MANIFESTO, 2014.

The majority of startups in 2014 that acquired financial assets came from VC funds. Other assets that startups acquired were from intermediary platforms (2%) from mobile platform financing and private investors (4%); while only 1% came from the Slovenian government. The financial capital market is not as developed as it needs to be in order to meet the serious financial needs of startups in Slovenia, which explains why most of them are leaving the country trying to find investors in foreign regions (Kupec, 2015). Another reason for that can also be the trend of introducing new funds (Eržen, 2015). Currently five startups, which managed to gain financial assets from Slovenian VCs, are now operating successfully abroad (Kupec, 2015). Logically startups wants to enter global markets because they need to have bigger opportunities and possibilities to expand their businesses. The important thing that we should look at is which Slovenian companies are positively effecting the Slovenian Entrepreneurial ecosystem, while also giving something back to the Slovenian community.

"Companies/startups are incorporated in a place where they see they can get the most of it – headquarters are usually located where the biggest market for their business exists. I would define a Slovenian startup a little bit different – I would say that Slovenian startup is a startup who has still a lot of cooperation with Slovenian environment and they are bringing something back to the Slovenian entrepreneurial ecosystem. Someone who moved from Slovenian with its startup to another country permanently would not be described as a Slovenian startup." Darko Putina, founder of a company Mimovrste (27th round table at START-UP CAFE: Role of Investors in Slovenian entrepreneurial ecosystem)

The economic crisis in Slovenia has shown major effects on the structural weaknesses in the economy, especially because of the high dependency on low tech industry and traditional services. This has restricted the economy making it weaker; it brought even worse results on the growth of startups and low share of innovative and high tech companies due to difficulties in obtaining financial resources for their development (Rebernik & Jaklič, 2014).

According to EVCA, the reasons for the undeveloped VC market are:

- Unattractive tax environment
- Funding constraints
- Rigid labor market
- Lack of incentives for VC investments
- Poor options for VC exits

As already mentioned above, the Slovenian VC market represents a negligible factor in the life of an entrepreneur. A lack of VC firms does not directly effect the creation of new companies, but it causes a loss of potential, which could account for the relatively low number of fast growing, young companies. As a result, it can be a reason for preventing the formation of tech companies that need higher amounts of seed and startup capital for their existence and which cannot obtain other financing sources (Vlada RS, 2009).

VC in Slovenia is a young category, which has a chance to develop in the future. The situation is not ideal in the market, but it is still a possibility to create successful global companies with big returns (Mikuž, 2015). The Slovenian government has to put VC measures in place to strengthen its core competitive ability which will thus fill the market gap, and with venture investments, promote the development of the VC market in Slovenia (Vlada RS, 2007). It also has to identify and activate youth in entrepreneurship (Mikuž, 2015).

2.3.1 Other important findings and advisory alternatives

Since 2000, alternative sources of funding have made it more difficult for VC to invest and attract early investment opportunities from startups (DiGorgio & Harris, 2013).

In the US, VC funds are increasingly recognizing the contribution of angel investors and crowdsourcing, and in some cases are collaborating on early stage investment with them. This kind of contribution can fill the gap in markets, extending the choices, and supporting entrepreneurs at very early stages of development, where even angels are very hesitant to join in (EY, 2014). With a rising number of startup firms, VC business – due to tech startup incubators and angel investor networks – are more accessible in the US for young companies than at any point in history, and are spread across the spectrum, working intently with early age companies to provide seed funding, while injecting capital into established companies planning to go public (WalkerSands Communication, 2015). Alternative investment sources are proliferating and entrepreneurs can also gain expertise and mentoring for a set fee or a small piece of action. But companies that rely exclusively on alternative funding face greater risks, are slower to scale and have lower profitability success. Alternative investors carry the presumption that entrepreneurs know what advice and expertise they need – and that is rarely the case (DiGorgio & Harris, 2013). That is why deals where both VCs and business angels are becoming more important – if angels or incubators provide first-stage funding to entrepreneurs, VCs can wait and see which ones show the greatest potential and then step in with their strengths (DiGorgio & Harris, 2013).

What we are noticing is that the gap in the evolution of the Slovenian startup ecosystem is increasingly larger (Initiative Start-up Slovenia, 2011) and the Slovenian government had to develop mechanisms to strengthen the development activities of Slovenian companies, which focus mostly on strengthening the business environment to improve entrepreneurship development. The government is trying to improve the technological environment by establishing supporting institutions and by increasing aid to small and medium enterprises (Krapež, Škerlavaj, & Groznik, 2012).
Other funding and advisory alternatives important for filling this gap are the:

- Slovenian Enterprise Fund
- Public Agency of the Republic of Slovenia for the Promotion of Entrepreneurship
- Slovene Export Corporation
- Slovenian Environmental Public Fund
- Technology in Action Slovenia
- Initiative Startup Slovenia
- Business Angels of Slovenia

The Republic of Slovenia has established the **Slovenian Enterprise Fund** to improve access to finance for development of entrepreneurship and to promote innovative startup companies to improve competitiveness (Vlada RS, 2009). Current standings show that development of small and startup companies in Slovenia are core resources for development of the Slovenian economy and their success is an important factor for growth (Vlada RS, 2009).

The **Initiative Startup Slovenia** was created to strengthen already existing national programs for encouraging entrepreneurship and ensure a network of comprehensive support for launching and building startup companies all across Slovenia. Initiative Startup Slovenia provides a comprehensive list of financial resources in the form of equity and debt financing as well as grants and subsidies, for startup companies with help from the **Slovene Enterprise Fund**, the association of VC providers, and other private capital providers (Initiative Startup Slovenia, 2011). What is important to point out here is that they attracted excellent mentors to the initiative programs, which use their knowledge and experience and are able to give to entrepreneurs quick and effective advice for the development of the product, business model, or business in general; and they open many doors with their network of acquaintances (Initiative Startup Slovenia, 2011).

The **Business Angels of Slovenia** aims to help companies with innovative ideas and visions to succeed globally and achieve fast growth. It consists of a competent team cooperating with European angel investment clubs, international businessmen, and other institutions operating in the startup environment (e.g. universities, institutes, and incubators). They help entrepreneurs with their investments, knowledge, experience, and social networks and become their mentors (Poslovni angeli Slovenije, 2014).

However, the diverse operations from different supporting institutions do not make optimal results. This point was also an issue that Jure Mikuž raised in an interview. Young companies mostly need help with investments, support for innovation, and also the supportive environment. This means mostly receiving help with running projects, networking, incubators, technological parks, and the educational environment. An important shortcoming Slovenia has is that it does not have enough entrepreneurship zones to give all the infrastructure young companies need to develop and also give them synergy (Erbežnik, 2010). If Slovenia wants to achieve, those long term goals cannot and should not be based solely on governmental financial support, but must also contain other elements that effect technological development such as organizational culture, a value reward system, legislation, tax and social contributions, bureaucratic barriers, human resources, and favorable bank loans, bank guarantees, and VC (Krapež, Škerlavaj, & Groznik, 2012).

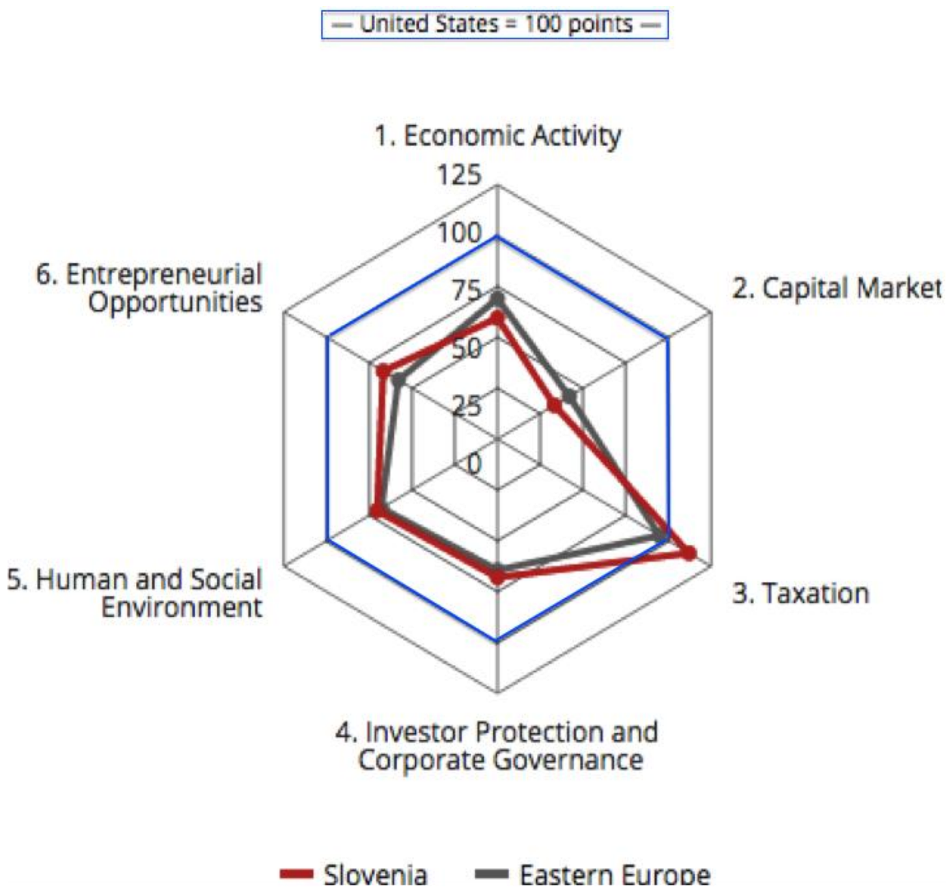
Slovenia has the foundation for establishing a support ecosystem, but the country is not yet sufficient for its full development. The startup ecosystem is not yet completely developed and some areas are not covered at all. Most areas are insufficient (Rebernik & Jaklič, 2014). It is necessary to raise the quality of support services to startups and to strengthen their integration, which can be achieved by efficient connecting, and improving the fragmented programs of domestic support institutions into comprehensive programs, and connecting them internationally. Slovenia should definitely strive to increase access to capital while continuing to intensify the support to VC investments by providing instruments that will enable domestic and international VC funds to invest in startup companies in Slovenia and local VC funds. Besides providing VC, Slovenia should also enable the transfer of knowledge between the local and foreign markets, as well as regional funds and companies (so called “smart money”). This will ensure further development of the Slovenian VC industry with internationally recognized funds and provide appropriate conditions that will make Slovenia interesting for investments from foreign VCs.

My exploratory research presents other benefits companies receive when Slovenian VC firms introduce money into a business; the steps they are using to help entrepreneurs grow faster; the potentially added value in comparison to all other help they can get with other initiatives. We recognize from all the factors above that startups receive help not just from VCs, but also from all other institutions that perceive the lack of knowledge transfer to small startup companies.

2.4 US and Slovenian market attractiveness for investors in venture capital

According to the Venture Capital and Private Equity Country Attractiveness Index, which measures the attractiveness of a country for investors in VC and private equity limited partnerships, Slovenia ranked 50th place. In 2014, its attractiveness was decreasing, meanwhile the US was ranked as the most attractive country of all and serves as a benchmark for other companies (Groh, Lichtenstein, Lieser, & Biesinger, 2014).

Figure 7. Slovenian attractiveness for investors in comparison to US



Source: Groh, Lichtenstein, Lieser, & Biesinger, Venture capital and private equity country attractiveness index, 2014.

With measures of attractiveness of a country for investors in VC and private equity limited partnership, we can see the current condition of the Slovenian market. Investors in VC and private equity funds have a key objective: to access transactions with satisfying risk and return ratios. They often set their sights on emerging markets. Mostly they are looking for factors shown in Figure 6 and their determination of relative positioning of particular economies and regions (in our case Slovenia) as they stand in relation with respect to their attractiveness for investment in VC and private equity assets (Groh et al., 2014). According to Key driver performance analyzed from IESE business school insight, the US is once again at the top 2014 ranking of Private Equity Country attractiveness index, while Slovenia only scored 54.5 points. Figure 6 shows Slovenian standings in relation to the US in six different factors, which in US each serves as a benchmark with a score of 100. It reveals that Slovenia is characterized by a relatively small economy with high unemployment rates and a small and illiquid capital market.

The VC market in particular constitutes a strong deficit in every sub-creation compared to the US. The human and social environment in Slovenia have high educational standards and good labor regulations constitute strengths. On the other hand, entrepreneurial opportunities are rather weak. In comparison to the US, the burden for starting a business is much higher. That is closely related with a poor innovation ranking, a small number of patents, and a low public and private R&D expenditure.

Surely the impact that VCs provide to startup companies in Slovenia is not even close to the effect of US VCs to their portfolio companies. The main reason is that the American VC market has background experience already rooted in its own culture, but in Slovenia that kind of tradition has not yet been developed (Kastelic, 2013).

Table 5 below sums up the most important differences, which characterize the Slovenian and US VC markets.

Table 5. Venture capital market comparison between US and Slovenia

US venture capital market	**SI venture capital market**
Most favorable entrepreneurial environment	Entrepreneurial environment is not as supported as it should be
Strong financial support for startup companies	Difficult access to external sources of financing
VC most efficient creators of tech innovation and job growth	Slovenian venture capital market represents a negligible factor in the life of an entrepreneur
Invested 0.17% of venture capital in comparison to its GDP	Invested 0.004 % of venture capital in comparison to its GDP

table continues

continued

US venture capital market	SI venture capital market
US venture capital has spurred the development of many high tech industries	VCs are a reason for preventing the formation of tech companies that need higher amounts of seed money
Flexible labor market	Rigid labor market
Strong incentives for venture capital investments	Lack of incentives for venture capital investments
Market for exit	Poor options for venture capitalists exit
Entrepreneurship plays a crucial role	High dependency on low tech industry and traditional services

3 EXPLORATORY RESEARCH

This section of the thesis presents the scope of empirical research and methodology behind the study. The results and main findings of empirical research, based on in-depth interviews with parties included in VC industry are presented.

3.1 Research questions and hypotheses

The main purpose of this exploratory study is to explore two sides of VC stories. I was interested in finding out directly from VC-backed companies and from VC companies themselves:

- To identify what kind of benefits investors provide
- To identify if added value is created before the investment
- To identify what the basic things that VCs are looking for when they invest in a company
- To identify the importance of relationships between VCs and VC-backed companies (formal and informal)
- To explore possible cases of management replacement
- To explore the differences between the global and local investments
- To identify reasons that bring problems to the surface in the relationship between VCs and VC-backed companies
- To explore the differences between the Slovenian and US capital markets

My two main research questions are:

1. Are companies just seeking money when they come to ask for VC investment or do they appreciate also a high enrolment of VCs to their business?

2. Do Slovenian and American VCs differ when it comes to value creation?

3.2 Methodology

3.2.1 Model design and the questionnaire

The exploratory research is based on the review of literature in preceding chapters on non-financial added value that VC brings the companies and on the analysis of Slovene and US VC business. Questions were prepared in advance to follow the relevant topic, while sub-questions were used where clarification was needed with interviewees. It is true that the number of representatives is very limited and small, but the study covers as much as needed. The representatives were initially clustered into four different groups:

- VCs operating in the United States
- VCs operating in Slovenia
- Companies that received international and national investments
- Companies that only received national investments

The questionnaire was prepared in a way that all participants were asked the same sets of questions. I was also able to incorporate the same questions for all groups.

3.2.2 Data collection

I collected the data between the 17th of August to the 1st of September 2015. Most of the interviews were done in person and some using the online communication tool called Skype. Interviews were first recorded and later transcribed. The average duration of an interview was 40 minutes.

Table 6. Interview participants

	GROUP	COMPANY	OPERATING COUNTRY
Interviewee 1	Venture capital group	Softbank Capital	United States
Interviewee 2	Venture capital group	Fairhaven Capital	United States
Interviewee 3	Venture capital group	Ten Eleven Ventures	United States
Interviewee 4	Venture capital group	RSG capital DTK	Slovenia
Interviewee 5	Venture capital group	STH Hammer, DTK	Slovenia
Interviewee 6	Venture capital group	DTK Murka, DTK	Slovenia

table continues

continued

	GROUP	COMPANY	WITH INVESTMENT IN
Interviewee 7	VC-backed company	4thOffice (Marg d.o.o.)	Slovenia / United Kingdom
Interviewee 8	VC-backed company	Printbox d.o.o.	Slovenia
Interviewee 9	VC-backed company	Zemanta, Inc.	United States / Slovenia
Interviewee 10	VC-backed company	Celtra, Inc.	United States / Slovenia
Interviewee 11	VC-backed company	MountVacation (OBS, posredništvo, d.o.o.)	Slovenia
Interviewee 12	VC-backed company	Visionnect	Slovenia

I conducted six (6) in-depth interviews with VCs, which are based in two different markets – well-developed (e.g. US VCs) and less developed VC markets (e.g. Slovenian VCs). Besides presenting experiences from the VC's side, I also presented the other part of the story – experiences that companies have when they accept an investment from VCs. This was achieved through five (6) in-depth interviews that concentrated mostly on the companies that have international and local VCs involved and companies that received investments only from local (in this case Slovenian) VCs.

3.2.3 Data analysis

After collecting all of the primary data, I arranged written records into predefined ones. Once I identified the data in this manner, I divided it into subcategories, which enabled me to improve the structure and do the analysis of the exploratory research.

3.2.4 Limitations

The topic of this study was represented within various literature. However, the literature only rarely mentioned the non-financial effects that Slovenian VCs give to companies they have invested in. Furthermore, a limited number of interviews were conducted and analyzed; therefore, the study should not be generalized to a broader extent. Another limitation was that I was not able to communicate with a desirable amount of US-based VCs. I only managed to make contact with those who invested in Celtra Inc – the internal connections, however, helped me get in contact with VCs from the US. The study offers a good first look into the investigated area and could be used for future research.

3.3 Results and findings

3.3.1 Reasons to choose venture capital investment

Startups trying to get their products to market face many difficult challenges, especially without anyone watching their backs and guiding their paths. They simply need assistance along the way, especially dealing with the relationship between founders and charters. Interviewee 9 said: “Startups are often very motivated when they begin a company; their minds are blurred with new ideas and a new way of thinking. When companies begin to gain financial assets there are not a lot of options that need to be met. It often happens that entrepreneurs have only one option and if they want to follow their dreams and realize their business goals, they will probably choose to work with VCs.”

There are many challenges that new startups face. For example, bank loans cannot be obtained under normal conditions, and no other investors will actively participate in building a business and bring value to the company in comparison with how much a VC does. To most entrepreneurs, VC investments are the only choice that is available. Most businesses that VCs invest in are completely un-investable by most bank standards.

There are many companies on the market and most of them do not have any experience with VC business. The problem arises because they do not do their research properly and do not know what VC investment is all about at the beginning stage. A Slovenian investor from ST Hammer in the interview sait: “If we take a look from the Slovenian perspective, VC business is a very young industry and most startups have not gotten a chance to learn about their options. As a consequence, companies do not often know the role of VCs, which, in my opinion, needs to be changed in the future.” Also I found out that companies are looking just for mony. An interviewee 5 confirem this by saying: “Entrepreneurs in Slovenia that seek VC investments are mostly looking for money upfront. Nobody actually comes to the investor because they have something worthwhile to bring to the table. VCs explain to them what their role is and expand their knowledge of the VC industry. Then new companies learn how much a VC can bring to the table and how much they can really add value in addition to financing.” Companies need to understand the role of VC and what the consequences are if they receive VC investments. On that topic, interviewee 7 had an interesting point of view: “When you enter the VC world it is basically the same if you go from the Slovenian National football league to the Champions league. The fact that you’ve come to the league means you’ve done a lot but the number one is that you really have to understand you are going to a different league; you have to be prepared that everything will change. You have to be prepared to do some changes in terms of rules and be opened to new possibilities.”

Companies that have more experience and knowledge take a lot of due diligence when choosing a VC. They need to know what to expect when the VC enters. Not many companies have a chance to choose. An interviewee 9 noted: “If companies have a chance to choose they will research by checking the reputation of the VC firm and at the reputation of the particular partner they will be working with. They will look at the main expertise in whatever the company is doing, at their track record of performance, and at their personality. It is important which VC they have in their portfolio because they differ by specialization. A company simply has to choose the one that suits the business model and industry the most.”

3.3.2 Characteristics that venture capitalists search for in companies

VC inventors do not invest in every company that has a great idea and a chance to become a potential for future success. There are a lot of factors, which many companies do not realize, that are more important to VC investors than just a superb idea. The most important is the chemistry between the team and VC; everything is about the team and the characteristic of the team. For example, Interviewee 3 from Ten Eleven Ventures, stated that ”there are many companies, which have awesome teams, OK products and business with VC can still get an amazing outcome. But with phenomenal technology and a crap team you do not get the big hit.”

Also an interviewee 4 noted that “it is important to have a team that will be able to steer the ship and be prepared to turn around if needed. All other factors change all of the time - environment, customers, and politics change and this influences startups. Therefore, the completeness of the team – managerial, business capabilities of the team – must be prioritized in order to see how they will be able to steer the ship and how they will be able to adapt if changes appear. The most valuable is the team that will be responsible for running the company and their experiences they bring to the table. There is always something that needs to be above all other factors that convinces a VC to make the bet and invest.”

3.3.3 Non-financial value added by venture capital from companies and the venture capitalist point of view

Entering in the VC ecosystem is much more than just receiving money; it is a whole process. As I already pointed out, VCs bring much more to a company than just money. An interviewee 7 mentioned that “for an entrepreneur, it is a long hard journey to success when they start their own business, and they often need somebody that is on one side a coach to them and furthermore, they need somebody that is financially adept who can also act like a buddy in times when the business environment is not as nice as one would wish.”

VCs have different ways of contributing to a firm’s success and this contribution also depends on the stage where the company currently is. The value creation starts already in the pre-investment stage and then continues in the post-investment stage.

3.3.3.1 Value creation in the pre-investment stage

As companies start to interact with a VC before the investment, a lot of things need to be done in order to make the investment happen. That is why an entrepreneur in the pre-investment stage should prioritize polishing the idea and strategy in a way to make them interesting and attractive for a VC to invest. In the pre-investment stage, VCs are there as mentors and advisors. An interviewee 4 explained: “Sometimes we set a challenge to a company before the investment and they try to change ways of thinking a little bit and maybe turn around the business model. The team then decides whether they are willing to take the advice or not. Those who do not accept suggested guidelines, we do not even consider investing in.”

In the pre-investment stage, VCs help the entrepreneur to position and help them strategically understand the context. They also explain what is important to them that should be important to an entrepreneur, as well. If the entrepreneur gets the money at the end of this negotiation, he has proven he has something more than just a good idea on a piece of paper. The pre-investment stage was explained by an interviewee 4 as stated: “It is a contribution to the entrepreneurial ecosystem, but it is a mere fraction of what an investor ends up doing once the investment is made.”

I got a different perspective from Interviewee 9: “In the pre-investment stage, companies try to sell the business and vice versa – VCs try to sell themselves as well. This is a stage of dating and flirting where both sides try to represent themselves. There is a lot of energy wasted for things that entrepreneurs believe an investor cares about, which sometimes is and sometimes is not the case.”

3.3.3.2 Value creation in pos- investment stage

After the investment is made, a company enters into an ongoing long-term relationship with a VC. Value creation there depends on the maturity stage where the company is. VC help them with a lot of different approaches. Interviewee 7 said that this is done “mainly by helping them build a strong business and not so much with being there to run it in place of entrepreneurs. When an investment happens, VCs recruit people to the team, run their financials, provide access to its network, introduce them to potential recruits and potential partners, and as well to potential customers.” Typically, VCs help support the company based on the experiences they have to provide guidance with the things companies have not gone through before. The VC investor also helps to make key decisions using experience that a lot of founders do not have. VCs are included in more strategic situations, they help with advice regarding strategy, horizontal advice on how to do the hiring process, on finance, on organizing the company, and on how to administer employee compensations, etc. As we can see, VCs play a mentoring role. They help with issues that they are more familiar with than the entrepreneurs, and they bring in diverse experience.

An interviewee 2 separated nonfinancial factors in three parts, as noted: “We can understand non-financial factors that VC brings into 3 levels: first one is actively operating on the board government; second is helping the company with strategic directions, such as building product roadmaps, organization direction, helping CEOs and the management team defining the strategy, business model, pricing, product, expansion; and the third one is giving them technical support.”

For companies just being backed by VC is a huge advantage at building the network and expending the business. Companies immediately improve their reputation just because they received an investment. They are more likely to gain customers and clients, and they will also likely receive following rounds of capital. An interviewee 9 explained: “If an entrepreneur is building its network, it’s much easier to do if a company is VC-backed. If the VC is known among the clientele of the company, that means the company automatically gains some reputation. VC opens up their networks so that entrepreneurs gain access to new people. It can be a big boost to in the process of obtaining first clients or some more important ones. Just having a VC in your portfolio opens new doors that would in other cases be closed.”

I would like to mention here that companies should realize that VC is not there to run the company; the post-investment support is when VCs are there just to be with the company. This was also marked from an interviewee 7: “VCs are there for an entrepreneur on the journey, they are there for an entrepreneur to offer support. And if a VC starts thinking that they have to do the CEO’s job, the company is not going to be successful.”

3.3.4 Importance of experiences in VC business in the process of value creation - differences between the US and Slovenian venture capital markets

I already found out that Slovenian and US VC markets differ in many aspects. The Slovenian VC business is much younger than in the US. Americans are simply more experienced because the ecosystem and environment is more supportive and encouraging for the development of businesses than in Slovenia. US VC business is more developed from the government side and how this entrepreneurial lifestyle is accepted and supported, there in a lot of different areas. I would say that this is the main difference. I would not say, however, that we differ from how we gain knowledge and experience. An interviewee 2 said: I”n the US there are a lot of VC firms operating that are more structured and more developed, with clear epicenters of influence (Silicon Valley, SFO and NYC, Boston, Austin, Texas, Colorado). There are a lot more VC firms, a lot more money, and a lot more specializations and expertise. The Slovenian market, on the other hand, is somehow emerging despite it being less developed and less experienced, but we can feel the gap is closing.” US VCs generally also have more in terms of experience, both financial and others as well. They also have larger teams, larger funds, and larger portfolios than Slovenians do. On the other hand, Slovenian VCs may be more prone to listening to all proposals. In the US, most VCs have more strict filters. Interviewee 11 said: “If you are a Slovenian company you do not have access to talent, at least from some specific segments or industries; networking and developing of a VC business started to emerge not so long ago. Now Slovenian VCs are somewhat renewed and are a bit more active. They gained more experience and are more familiar with the business they are involved in.”

Slovenian VCs invest less amounts of capital than those in the US and they are somewhat efficient when it comes to helping their companies, but only when entrepreneurs are just focusing on the local market. Sooner or later companies want to reach global markets where international VCs are having a greater effect. Some of my interviewees have different experiences when it comes to Slovenian VCs. It was mentioned in my inetreview that RSG Capital is one of the top VC investors, and their quality is totally comparable to those you’ll see everywhere else.

Experiences are important when companies choose a VC because what they often equal to is the amount of connections and good standing of the industry, which VC brings to the table to help the company. Entrepreneurs need to find VCs that have useful knowledge and experience in the business and industry they are involved in. They also need to find VCs that are aligned with the specific business culture the company has. Each company wants to have an owner with a lot of experience and a strong network built around them to open doors – one who is right for the team and fits in well with the organization. This is certainly a major factor. But there is often a question whether a company has the opportunity to take advantage of such a factor and if there is any possibility to work with such a VC. Interviewee 7 noted: “If a company is able to choose, which is not the case in many examples, experience surely matters. Companies should seek a VC that is a good match in terms of what the VC has experienced and what they can offer in terms of business connections.”

An interesting perspective that I found is that there is a difference how Slovenian VCs control the money invested in companies in comparison to the US. Slovenian VCs want to see that money stays in the company for a long period of time, but in the US if a company spends it right away they will get the second installment with no issues. The biggest difference between Slovenian and international VCs is the problem of indecision. When companies abroad receive money from VCs it should be spent according to plan, but you need to send it right. If you go in the right direction and are still a little low with the money, you will get the second round, as long as it can be proven that the money will not bring bad results. In case it cannot be proven, the business can be shut down or go into new projects. In Slovenia, when you get money, you need to start saving it so the money will last as long as possible and avoid needing a second round of capital very soon.

Most VCs would rather invest in companies that are close to their headquarters than to some foreign country where they could not have a great effect on the business or help with development. Typically a lot of American VCs would not invest in firms outside of the US markets or their national area. This interesting quote was mentioned in the interview from Interviewee 5: “Far from the eyes you are far from the mind!. A VC’s influence is only so far out from their location, which is why geography matters so much. The main difference is the efficiency of help that companies receive if their VC is close, in comparison to when they are present simply on paper. The physical presence is the main reason that relationships develop and establish strong and ongoing communication with the company. It is also easier to understand the environment in which the entity operates.“

This awareness of having a VC close to the business is present also on the company’s side. They know that VC is a local and people-centric business. The amount of help they can get from VC is much more impressive if the VC is located in the same area. Interviewee 7 made a very interesting point on this topic: “Once we got a UK investor, the business moved to the UK because we wanted to have the most important member by our side. I wanted to talk with them, to meet up, to be part of that journey. This is not a journey of one meeting per month, it is a journey of online discussions, and meetings, pub-crawls and if you do not have that kind of relationship this cooperation cannot work. That is why VC in my opinion will stay a very people-centric business.”

If a company’s market is in the US, the amount of help from a Slovenian VC would be relatively small because the market here is really small. We cannot say that Slovenian investors are bad or worse; it is just a matter of location. Interviewee 9 said: “If a foreign company is located in Slovenia, outside of the core market, companies simply do not have the same amount of connections, insides in the market, and environment compared to when a VC is located in their core market. I do think the efficiency of location explains why a lot of the best companies just move.”

It is beneficial when companies have both international and local VC support. In this way, companies operating as local businesses can have open doors to much more markets. They get investments from outside, while on the other hand, they get help from the area where the company operates. From a company’s perspective, they would like to have a local partner who can help them manage the team and business. It keeps them honest to a certain extent. If no VC is on the ground there, companies cannot comprehend how the VC is really doing it. In that case, international VCs mostly help by providing some agency contacts if they need to expand globally. But in reality, it is highly beneficial to have both in the investment portfolio.

I would say that location and the presence of VC is very important when it comes to value creation, as well. VCs that operate far away from a company's headquarters do not have a lot of interaction and the influence is less great. They also have weak control over companies.

3.3.5 Management replacement cases

Replacing an important member of the team or even CEO is one of the most unpleasant jobs that a VC needs to do. But on the other hand, it could have a good result after all. This happens in cases when a company is not operating well and is not headed to reach its goals. VCs need to have such control to prevent bad performance – they just have to do it once they have any suspicion that a senior member of a management team or the CEO is not working right. The reason is mostly because of constant bad performance; it is not done when companies miss one of their milestones. Interviewee 6 said: "Sometimes this is the only possible way to reach the goal. If you have a founder at the forefront of a company that is no longer on the agreed and expected direction, who is no longer achieving the desired results, this can lead to destruction. Replacement can prevent this from happening."

The decision to replace someone from the management team or a CEO is not very well accepted by the company's team, but in the end, the team needs to understand that this is the only possible solution to continue the business as planned. There are also cases when a company proposes such a change and sees that something needs to change. This is very hard for some companies, but once an entrepreneur gets attached, they still need to understand that everybody wants to do what is best for the company. Interviewee 5 noted: "Very often the management itself or part of the management gives this initiative and VC basically has to support it or pick sides. Usually the decision is made with the board and a CEO or a CEO himself makes the decision. It is rare when the board itself is involved in the firing decisions. Typically a CEO consults with the board and accepts the decision with the board at the end, but it is a very difficult and hard decision to make."

In case this situation happens, the action needs to be make quickly. Interviewee 6 explained: "If the process lasts too long, it can happen that you miss some opportunities on the market or somewhere else because you are just there dealing with a problem that is not connected to the main business, which needs immediate attention. Once VCs realize that a team member is not right for the position, they should simply let that person go. The biggest mistake would be that the process takes too long. One of the most important competences is to understand and realize the moment when a team, team member, or CEO comes to the point when they stop performing well."

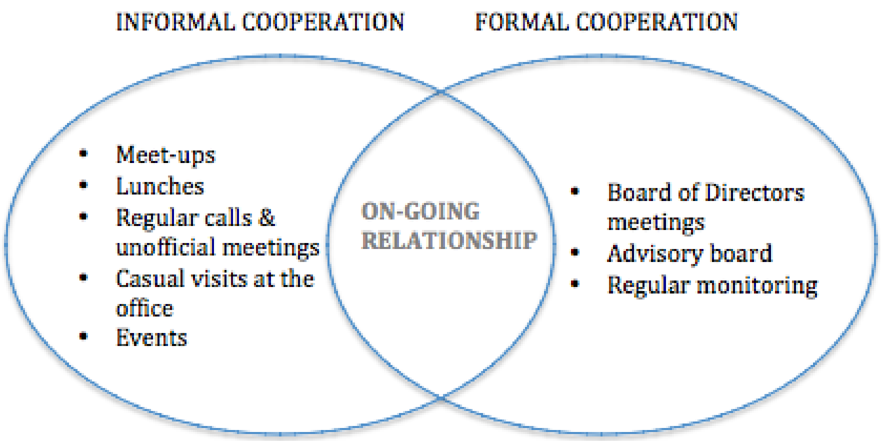
The action also depends on the environment and situation a VC or a company is. An interesting opinion arises from this question. If the environment allows them to quickly replace a CEO they will do that; if the environment does not allow them to do that they will keep the existing one. In my research I found one example from my interview regarding what possible outcome came out off this and happened in Slovenia. Interviewee said: “As a CEO I proposed that I should withdraw, because as a business owner I said am not the right person for this position and that I would be more worthy somewhere else. The answer from a VC was that I cannot be withdrawn because we do not have enough money for someone else to take the position. Foreign investors would in this case say goodbye and they would move on, but in this situation the process was taking too long.”

3.3.6 Formal and informal cooperation between VC and backed-up company

The added value creation comes from the cooperation inside the board of directors, but the huge effect comes when the interaction is headed more toward informal cooperation. With this, the whole process adds value in the end. Board of directors meetings are important, but also interaction with the team off of the board is necessary for a strong cooperation to succeed. This was exactly described in Celtra’s case, when Interviewee 1 mentioned: “I would like to share my experience with Celtra. I can compare it with a unique bonding experience and it is kind of a thing that draws everyone together. It helps when you are on the phone, talking to people in NYC and you know all the employee names – it is a different level of a relationship - unique advisors board, management team and then the whole team. You cannot do that if the company is distant. You could not “pop in” on Friday afternoon and check if people are in their offices and if people are working. From investor point of view that is good to have.” Board of directors meetings are very formal meetings where you go through processes, approve them, and give advice on what to do further. Informal meetings happen outside the boards and are done by having multiple calls, meetings with CEOs, doing introductions and connections, brainstorming, having coffees, etc. Board of directors meetings happen once a month and there are not a lot of things that can be resolved. If you are talking with the company just once a month, entrepreneurs have an even bigger problem. A strong balance between informal and formal cooperation needs to exist.

In which way the cooperation is headed depends on the company and a VC. Some companies do not want to cooperate informally and not all VCs are in favor of it. All portfolio firms that VCs invested in have a different attitude to the proceedings and this is mainly because teams differ. How often VCs interact with their CEOs really gets down to the individuals involved. Investors, in general, are at the disposal of entrepreneurs anytime that he believes there is some use of talking to them or asking them for help. In my research there was also a different case with one of the Slovenian VCs, where the interaction was more of a formal structure of cooperation because they did not want to be involved in day-to-day operations. Rather, they wanted to just be involved in board meetings and be a part of the advisory board. There is a fine line between being a VC and being a mentor or being both. Some of them do not want to actively influence or be very proactive into day-to-day management. Those say that VCs seek companies they want to help succeed, but their primary target is a good return investment; their main goals are financially-driven. Figure 8 visually presents the cooperation between VC and VC backed company and presents an informal and formal cooperation that form an on-going relationship thatis important for the successful path.

Figure 8. Informal and formal cooperation between VC and VC backed company



Source: My own exploratory research

3.3.7 Information asymmetries

Information asymmetries exist and that is why the extent of value creation varies depending on the amount of information shared between a VC firm and a CEO of backed up company. In case a company does not share all-important information with a VC, the value creation is not going to be as great as it can be. VCs in general have a lot of experience and knowledge that can contribute much to the development. It is important to note that a VC has to be on board with everything that a company is doing so there is a possibility to react at the right time because it is difficult to change anything if it is too late. Every piece of information will come out sooner or later. I think trust is a major factor in this kind of relationship and it needs to be brought to the table and be nursed every day both in the pre- and post-investment stage.

From my exploratory research I found out that companies in general share all the information that are important to them. They are aware that this is important for continuous and efficient cooperation. Interviewee 7 mentioned that companies need to identify the core issues that are part of the business. It was said: “Sometimes entrepreneurs do not mention issues that they think are not core and important. In case a team puts all issues on the table, the board will be doing too much of the company’s job, which normally is not a good sign.” Often, some information comes to a VC a little bit later because the information at that moment is irrelevant and not important. This creates a situation when a

VC cannot have influence over the course of events and might not actively participate in solving the problem. Entrepreneurs in general try to be as transparent as possible.

Problems may appear when specific information is hidden, especially given that entrepreneurs have a tendency to hide things that are not going in the right direction. This might bring up some negative issues between a company and a VC. Realistically, VCs would firstly change the management team if needed data would not be accessed and would also make sure to replace it with those people that would do all of the needed reports. Therefore, the financial picture would be relevant and given in time. A change of founders happened in one of the companies I interviewed because the team that worked before operated behind the VCs back. They also did not do their reporting and the relationship was put to the test. In this case, the management team was changed.

3.3.8 Monitoring as an added value factor

Monitoring is important when it comes to value creation – companies appreciate if someone is there to control their business. A lot of entrepreneurs know that it is a good idea to have a VC watching over them to keep them honest. Monitoring is a key factor in helping manage the company, and overall, it should add value. Also, from an investor's perspective, monitoring is definitely the added value function. Monitoring is good because companies get the discipline to check if set goals are achieved. Monitoring allows discipline to quickly react to things that need to be done.

I found out that companies understand the monitoring process, but they are mostly not in favor of doing needed reports because they are time-consuming and they do not see the direct value in it. Interviewee 11 said: "Monitoring shows what to be focused on and should be present in every company. Even if an entrepreneur does not know how exactly he should solve the problem, at least he knows what and where the problem is. A reality check needs to exist. Monitoring gives entrepreneurs a comparable benchmark." The VC has to be able to prepare key performance indicators to evaluate performance. Furthermore, companies should be organized along with certain guidelines. They need to get their reporting together to keep some processes going, which on one side, can be a burden because they need to put the energy where there is no direct benefit. On the other side, they need to promote healthy business management. These approaches of having control over the business and demanding a lot of reports is great if it has its meaning. Sometimes VCs require something that has no meaning to a founder, and the reporting takes a lot of time because there are much more important tasks to deal with.

An interviewee 4 stated: "The monitoring function is very important and comes in front at the beginning when the initial investment happens. It is something that creates a trusting environment through building a strong relationship. In the early stages, it serves to prevent mistakes, it helps steer the company or advising management, and it also gives a chance for VCs and management to discuss issues that may arise." However, trust is still not built immediately after the investment, meaning that there is basically only monitoring going on. After the relationship has some routine, this reporting and monitoring gets normalized, where both the VC learns to trust the entrepreneur and vice versa, while the entrepreneur learns to trust that they can share basically much more with the VC because they will not be asked about every single small detail and decision.

3.3.9 Factors that ruin relationships between venture capitalists and backed up companies; and reasons that might bring problems to the surface

There are some tendencies and pressures between a VC and an investee, which can be a result of an unsuccessful and ineffective cooperation. There are many reasons for this to happen. An Interviewee 8 mentioned: "Mainly this is because of misaligned goals and inexistence of trust between both parties. A lack of consistency with set goals on both sides is the main obstacle here. If they have opposing views on the business or on what is the right process for achieving something, this can lead to an ineffective relationship. Problems arise when companies are not doing well; then it comes to disrespect of previous agreements and ultimately to distrust. This can lead to poor performance and excessive control. VCs do not intend to lead and develop the company - if this happens the relationship starts to break down."

Entrepreneurs at the beginning stage of development are skeptical when they choose VC and sometimes it happens that they go for a VC investment just because they do not have any other choice. There is a lack of financial options for entrepreneurs in Slovenia and worldwide. However, the lack of other options should not be the reason why a company goes with VC funding. Interviewee 5 noted: "They really should be willing to accept VC funding for all its benefits or downsides, rather than going with VC because they cannot find another source of financing anywhere else. Also, the entrepreneurial lack of knowledge of VC business makes them insecure about intellectual property. Entrepreneurs are afraid that VCs will take their ideas and steal their companies. Mainly this happens because companies do not study VC properly." If they decide to take a VC investment, they should be aware of all the characteristics of the business they choose to be involved in. Firms in less mature environments are afraid for their intellectual property. They overestimate the value of their own ideas and are afraid that VCs will take over. There is also a fear of being under control because they want to handle everything and have their own control on the things that are happening - but if there is VC inside that automatically means that some part of the control is given to them. Interviewee 7 stated: "If entrepreneurs decide for the VC, they enter to a new ecosystem, and have done their homework. And if CEO has enough self-confidence, he will be the one to drive the company. Entrepreneurs must understand the ecosystem of the VC."

The above-mentioned aspects of bad relationships may bring the collapse of the firm or the earlier exit of VC than expected. If it is not possible to change the management team, then this can be a result: The company finds a new VC and the existing one goes. The worst that happens is a backlash, when a company starts to think about who will be the new investor and a VC thinks about who will be the new CEO and does not offer any help to the company anymore. This is not beneficial especially because of the global and fast-changing environment where you can immediately lose an advantage and miss the market timing.

For an effective relationship between an entrepreneur and an employee, some important values need to be present. This industry is very much based on trust. As soon as your trust disappears, both startups and investors can lose sight of the relationship. Trust is the only way that the cooperation will head in the right direction.

Below I separately noted a few quotes about this important factor when talking about the relationship between VC and an investee.

1. **Consistency of goal and values** orientation from VC and the backed up companies (Interviewee 4)
2. Board has to be aligned; and to be aligned means transparency, dealing with issues, **trust** and basically understanding that the Board is not going to solve the problems and ask you the nice questions (Interviewee 7)
3. It is a small marriage. If there is no **trust** and no personal fit, the relationship is slightly going to fail. This relationship starts with trying to be nice and friendly and trying to present the best face to everybody, but it has lots of tension down the road. If the interest of the VC and the management are aligned, and through the years they will not be perfectly aligned any more because there will be more people involved – how we find a common path is difficult and that is why a personality fit is so important (Interviewee 5)
4. If everything goes according to plan, then this is a fairytale. When problems appear these relationships comes to trial and then we need to work on building **trust** (Interviewee 8)
5. Strategic influence – if the direction is not right you lose the business. If there is no **chemistry** involved, then it is over (Interviewee 6)
6. Understanding the business, **trust** and consistent objectives (Interviewee 2)

4 DISCUSSION AND IMPLICATIONS

The Slovenian VC industry is still at the very early stage of development, but over the years it has started to emerge. For many parties in the Slovenian entrepreneurial ecosystem, the business of venturing is very unknown. The lack of knowledge about the business among entrepreneurs may be the result that VC investors are not so reachable and do not have so much effect as those in the US. The problem is that entrepreneurs who come and ask for VC investment do not know what kind of business they are entering. Slovenian entrepreneurs do not have a lot of financial possibilities available for their businesses and just receiving or getting money from some kind of financial investor is a big success – they do not see other added value activities they can get from VCs. Also, a small number of VC providers give Slovenia very limited possibilities in business development.

Based on answers I gathered from my exploratory research, I also found out in what aspects US VCs differ form Slovenian ones. From US VCs you might get much more added value than from the VCs in Slovenia. This is because of the very well-developed industry that has a longer track record and extremely strong networking. The important issue here is that in the US a lot of portfolio startups from one VC help each other in the development stage. In Slovenia, this is hard to achieve because Slovenia does not have enough companies in a similar stage and industry. This is an important notion when it comes to connecting with foreign VCs. US VCs are better in terms of gained experiences due to their more supported environment where VCs are located. They are well supported from the government side, and also from the positive acceptance of entrepreneurship among their people. With clear epicenters of interest, the US has created an environment where companies can develop quickly and efficiently. The one thing that is lacking in Slovenia compared with other emerging and developed countries is a real decision on the government and country levels that innovation is a part of the overall development strategy. If this is the case, then as an investor or a company you need to start building all sorts of laws around taxes, investments, and promotional entrepreneurship. Those things are done in a lot of countries already and obviously Slovenia is a little bit late in this regard.

US VCs also generally have larger teams, larger funds, and larger portfolios, which can have a positive or negative effect on a startup company. One negative effect is that the VC is not prone to listen to each company's proposal. In the US, getting in contact with a VC is very hard and they usually do not invest in companies in the early stage of development – even well-developed firms have issues with raising VC money. One positive effect, however, is that receiving investments from US VC gives an advantage to grow faster. A very interesting point of view on this topic was raised in the research: "There are good and bad investors regardless experiences gained". I would point out that we have some Slovenian VCs that are known to be very effective and helpful investors that add a lot of value to help entrepreneurs improve and become well known in the local area. But it often comes to a point when entrepreneurs' goals become bigger and they want to expand globally by bringing their business to international markets. Usually entering the global market demands an investor that is closely related and to a specific expertise. If a company wants to enter the US market, they need to find an investor who will be there for them and who has a lot of experience in their business interest. As I have mentioned several times, in international markets connections and knowledge in the specific industry are very important.

From an investor’s point of view, it is very important to have a company nearby, in order to have the opportunity for ongoing interaction and control over the business. VC business is a very people-centric enterprise and that means that typically VCs do not invest in a company that is far from their realm of interest. If a global investment takes place, entrepreneurs like to have local partners who can look after the business and keep them honest to a certain extent, especially in the early stage of development. Also, Slovenian VCs have the same opinion in this matter. They say that a physical presence is the main reason that relationships develop to establish good and ongoing communication. As I have mentioned, VCs are more familiar with the market they are located in. This is because the environment is known to them. Therefore, the help they can provide is much stronger if the market is well known. When companies enter foreign markets, getting a global investor is a very critical and important factor that helps businesses to develop further.

From a company’s point of view, starting from scratch means just getting initial money to begin. Normally, where they get it is not important. Slovenian entrepreneurs start their business usually with the reason to expand and enter the foreign market. It is important for them to get an investor that has specific market expertise; they don’t want to stay oriented to the Slovenian market. It is a perfect combination for a company to have both, local and international VC. Many companies that get investments from local VC usually are present in international markets rather than only local. If a company’s market is situated outside Slovenia, then the amount of help at the end is relatively small. Therefore, entrepreneurs have to find someone that will be beneficial in the end – someone who knows about the market, who can bring a lot more connections compared to the local VC. This will give more access from within both the market and the environment.

My findings show that in reality the Slovenian market is so small that even those three VC actively operating firms are too much. We have to see the real situation that we have in Slovenia; we have to realize that the conditions are not so good and are hindering the entrepreneurs that have high business expectations. My perspective about this issue is that there are too many entities nowadays that are trying to help Slovenian entrepreneurs. Because of such a small market, it would really be necessary to change conditions and create an environment with the possibilities for young entrepreneurs to succeed with less barriers. We have already created some initiatives that help entrepreneurs realize ideas, but we have not created a proper environment with the entities to help entrepreneurs convert their ideas into real businesses. Therefore, VCs and business angels should have a greater role. Specific focus on entrepreneurship development could really improve the chances of changing the local market. I think that such a small market does not need more VC providers – we just need one that is well-developed, has aligned goals, and is very well-structured to provide everything an entrepreneur needs to develop.

From my research I found that we need to share more success stories, as well as discuss the stories that were not so successful. Entrepreneurs can learn from these cases a lot, but we have to be oriented on the Slovenian market and not so much on the US. Firstly, we need to learn and write about conditions in our own environment in order to understand the differences and opportunities, and then compare our stories outside of Slovenia. Some companies in Slovenia are also involved in international markets and some of them are very successful. Investors can learn a lot from these companies, entrepreneurs, and also VCs. One really great strategic advantage in Slovenia, is that the lifestyle is a big plus in comparison to other countries. Another big advantage is all of the Slovenian entities that decided to relocate their headquarters to the UK or the US. They keep development in Slovenia by bringing back something to the community and convincing young companies to do the same. They also increase activity in Slovenia instead of just leaving the country for good. This is a strong incentive that is important to take into consideration.

One of my interviewees said that Slovenian VCs have a chance to learn from other investors outside Slovenia and have a huge opportunity here to connect with US, but unfortunately they do not grab the opportunity as much as they should. This can be perceived as a big opportunity for Slovenian VC business. Investors can learn from more experienced ones and study and participate in best practices. Also, being involved with other VCs who are more experienced and have a lot of advantages to bring to the table would benefit their development and broader understanding.

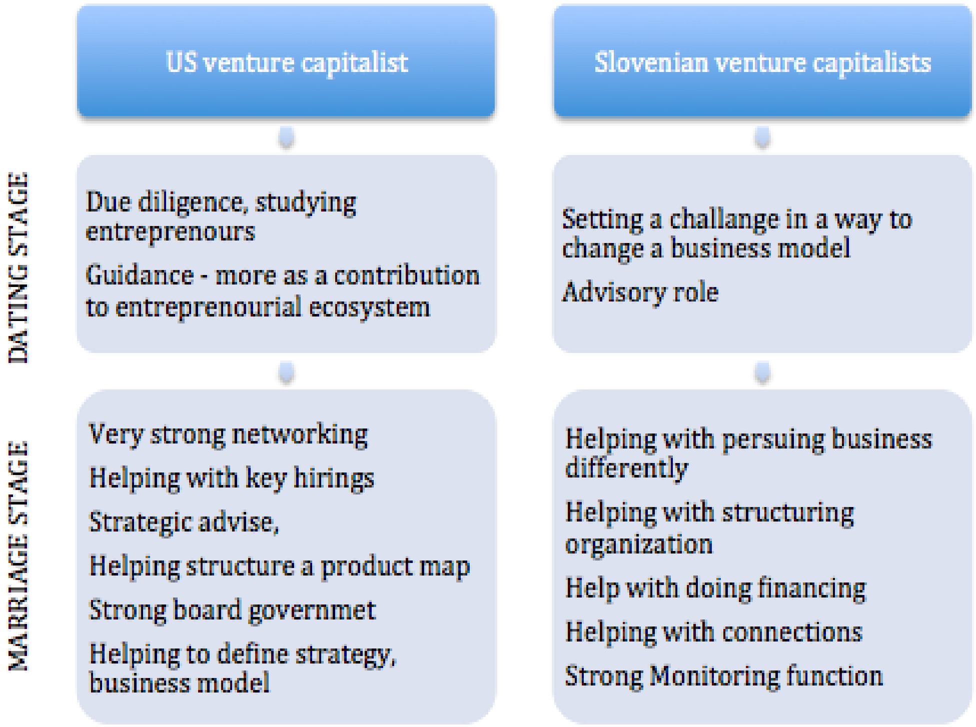
The perception of the importance of entrepreneurship in Slovenia is very low. They do not realize what the effect of healthy entrepreneurship is and how important it is for the economy nowadays. Instead of focusing on big companies and saving them, they should really look the other way around – entrepreneurship is now the lifeline to improve an economy. The government is constantly talking about the solutions, but their implementation is not even close to realization. VCs in Slovenia are constantly saying that government should stay away from the VC business. Their role is mainly to create the environment where companies can start to develop, but they should not be involved in the VC business. The Slovenian law written for VCs is problematic because it only represents barriers to create a healthy environment on tax and infrastructure, and in that way, accelerate VC firms to expand and develop. Just by providing entrepreneurs with information on how and what they need to do to start a business, the orientation should be more focused to give them an easy path to implement their ideas. The support here needs to start with restructuring or improving school systems, promoting entities that help entrepreneurs create themselves, and improve collaboration with VCs that will help entrepreneurs develop in a way to provide them enough financial assets and non-financial assets. An improved perception of entrepreneurs needs to start in high schools and universities. We have to create a perception that starting your own business is important and we need to present the opportunities and ways to make this happen. The US market should be an example by showing how to create a school system that promotes entrepreneurship from an earlier age. That is why the US environment is so much more supported than in Slovenia.

My exploratory research showed that entrepreneurs are very skeptical when they are deciding whether to receive VC investment or not. Mainly this is because their knowledge about VC business is unknown to them. In my opinion, this is one of the problems that could easily be solved. Implementing this topic to all university faculties would be a very beneficial solution, and with some creativity, this topic could be more interesting to students. In my opinion, this needs to be done together with the government, teachers, and other entrepreneurial accelerators and VCs. This would benefit the perception of the VC industry and the positive effect one could get with having them in one's portfolio. Also, providing free workshops to students and future entrepreneurs, free conferences and other classes and competitions with financial incentives would be beneficial to promote the possibilities of entrepreneurship.

Second, the government should have lower administrative barriers for entrepreneurs. As I found out, there are many things that need to be done in terms of administrative procedures that the government are demanding from entrepreneurs. Those procedures are unclear, confusing, and time consuming, and usually present a big problem for entrepreneurs. Also, the investments and some financial initiatives they provide to entrepreneurs demand too much paperwork and no other benefits after receiving the money. There should be some responsibilities that entrepreneurs need to have after receiving the money – it should be similar to a VC investment. They need to make sure entrepreneurs connect with accelerators that will help them develop their idea with the money they obtain, and after a while, they would need to show the progress and justify the financial assets they received. A mixed jury composed of government representatives, VC representatives, and business angels would need to estimate this progress. After showing their progress they would need to encourage entrepreneurs to engage in the VC system. This would be a start for a whole new entrepreneurship construction. Before this, we need to change perceptions, then take steps toward building an efficient entrepreneurial ecosystem. In this way, we would promote Slovenia from the inside and out, would encourage people to stay in Slovenia, entrepreneurs to build Slovenian companies, and somehow structure a better living and working environment.

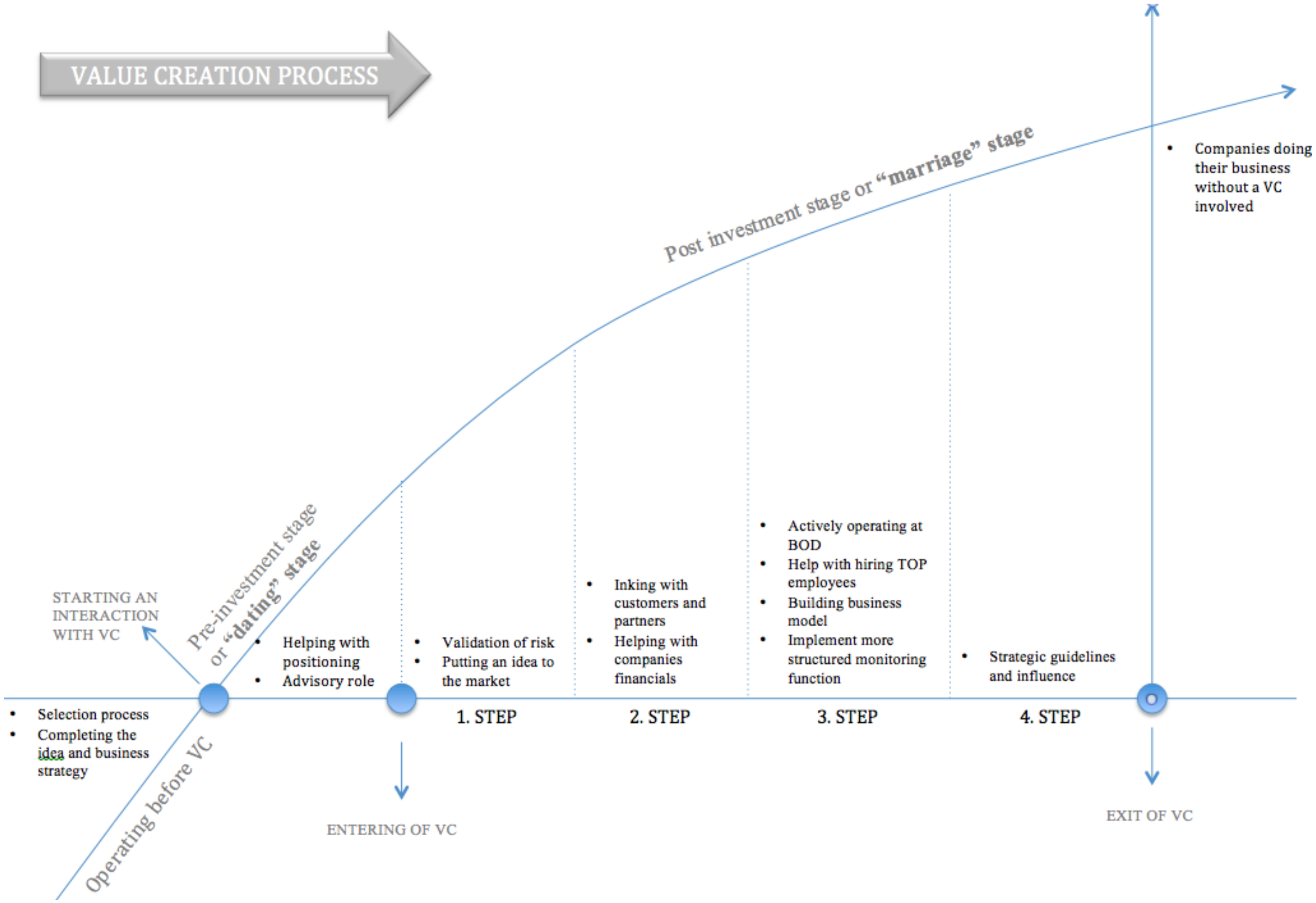
Figures below show a visual presentation of everything I researched in my master thesis, including the main differences between the US and Slovenian VCs in value creation. I also present the VC value creation process of a company backed by VC. It is a visual display of value-added activities that are important at different steps of a company's development.

Figure 8. Differneces in value-added between US and Sloveniann venture capitalsits



Source: My own exploratory research

Figure 9. Added value process from venture capital firm to its portfolio company



Source: My own exploratory research

CONCLUSION

Startups face many challenges in the beginning because they do not have much knowledge about how to run their companies, and very often they do not have a lot of financial resources to run the business properly. Many financial providers are reluctant to lend money to risky businesses, therefore, VCs are one of the main financial supporters that are ready to invest and help startups. VCs help startups by providing both financial and non-financial support. This master thesis examines non-financial added value that VCs provide to their portfolio companies and how we can detect differences when it comes to the VC market development stage. The research also discusses the connection between VCs and entrepreneurs as a people-centric business relationship. Besides provided financial assets, they are using many approaches and activities to offer startups support in business development. The extent of support relates to VCs' experiences, background, and also depends where the VC firm and VC-backed company are located.

Added value may be provided before the investment with guidelines that VCs ensure a new company goes in the right direction, and improves their business strategy and plan. In general, it is only a fraction of what are they doing when investments take place. Added value is provided first through formal communication by serving as a sounding board for the management team and through well-structured monitoring. In that way, VCs and startups begin to build trust, which is the most important thing that should exist in the relationship. By structuring appropriate human resource management, VCs help to gain top talent, which is hard to get when newly born companies come into the market. However, VCs extend the startup team and make them stronger by strengthening the internal organizational structure. Gaining the right customers and clients makes a company even stronger, and just having a VC beside them makes a difference, without any help provided. VCs provide introductions and open new doors to portfolio firms that in other cases would be closed, and give a needed boost at the beginning of development. Companies need guidelines with strategic advice and help with building stronger organizations. Having VCs with sound knowledge to strategically influence creates a strong effect when it comes to value creation.

With experience and knowledge, VCs lead teams in the right direction by structuring the right business strategies. This is why we can say that experience is very important when talking about choosing the right VC for an investment. When a company selects the right VC firm, it needs to make sure that it is right for the team and for the business they are involved in. Having a VC with relevant experience in the same area of business will usually bring the biggest benefits of all. Usually startups are not able to choose between many VCs, and just getting one might be enough for the beginning. When a company develops its network a bit, investors broaden. And if they are big enough, they might have a greater choice among the VCs and reach for those that will bring the biggest value to the business.

The paper also investigated VCs between the US and Slovenian markets. The VC industry has existed for decades in the US, but in Slovenia the industry started to develop just a few years ago. My thesis presented some fractions that exist between those two markets. The Slovenian VC market, for example, is very young and underdeveloped in comparison to the US market. Slovenia could improve itself with the development of an entrepreneurial ecosystem, which is far more supported in the US. US VCs are also stronger in terms of experience and broader knowledge among various industries. Because of the small Slovenian market, this is not the case here. Also, government could support a crucial role for this underdeveloped market. Furthermore, the Slovenian government does not give enough support because they do not perceive entrepreneurial importance and innovation as a part of a larger strategy, like in the US. Another aspect that should be mentioned is that US VCs have more assets available for funding, firms are more structured, have larger teams, and the number of active VCs is much higher, compared to Slovenia.

By exploratory research based on 12 cases with representatives from US and Slovenian VCs and companies that have experience in international markets; and Slovenian companies that are present only within the local market, I found that VCs do add value in general and have very similar procedures to the US. I detected more differences in regard to added value from US VCs than from Slovenian VCs. However, I can confirm that added value is provided by both, but because of a stronger US VC market and infrastructure, there is much more value to give to entrepreneurs in comparison to Slovenia. Entrepreneurs in Slovenia most likely first search for support and financial assets in their local area, but as soon there is a need to go abroad, they also need investors that will be able to provide them with more financial injections, access to a wider network of people, and VCs that are more familiar with the industry in which the company operates. Slovenian firms lack experience, which is why in the mature stage of development, foreign VCs play a bigger role in the life of a VC-backed company. Being involved with a VC simply brings more value.

Furthermore, both of my hypotheses were supported. The research revealed that besides being financial supporters to startup companies, VCs provide nonfinancial support to their portfolio firms by helping them to reach their goals and to grow further. The value added differs in many aspects, such as in which stage of development the company is, where it is located, and in what kind of business or industry it operates. Also, it depends on which VC is chosen, how experienced the VC firm is, how diverse its portfolio is, and how efficient the cooperation between them is. It all comes down to how effective the team is that builds a company and its decisions.

It is important to note that I did not find any prior research about the value of VCs in the Slovenian market. Therefore, this thesis can be very beneficial to all that are interested in getting involved with a VC business.

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