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Venture capital activism: how to foster sound investor-entrepreneur post-investment relationships?

Research Master's Thesis submitted by
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I would like to extend my gratitude to my supervisor, Gerrit Sarens, who has been instrumental in the definition of my thesis topic. Not only venture capital activism has been an interesting topic to delve into in the frame of a thesis, but it has raised my interest for future career purposes.

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Abstract

Fast-growing startups are widely associated with the venture capital (VC) industry. Venture capital financing is for startups an impetus to, *inter alia*, investments in human capital, products, technologies, investigation of new markets, *ipso facto*, driving scale and growth.

As of writing, the size of the VC industry and the current momentum for entrepreneurship sparked the interest of many academics and policy-makers. The literature is consequently well documented on several core topics related to VCs such as their decision-making process, their internal firm organization, their risk-return profile or the determinants of their exit strategies. Nevertheless, besides the mere provision of finance, the literature has identified a post-investment value-adding role for VCs; these investors provide "more than money" in the investor-entrepreneur relationship, and thus are considered as active investors.

While the venture capitalist's active role has been covered by a plethora of academics and practitioners, there is no convergence over the empirical evidence of the net impact of the venture capitalist's involvement and the literature remains vague on what is the right degree of investor's involvement. This highlights the need of opening the black box of VC involvement in portfolio companies and the urgency of understanding what degree of investor's activism promotes an investor-entrepreneur relationship built for positive venture outcomes.

This paper studies the investor-investee relationship with the governance mechanisms ruling this relationship and venture capital activism as key underlyings. The envisioned output of this paper is to provide entrepreneurs and venture capitalists with a set of actionable recommendations for the stimulation of sound investor-entrepreneur relationships.

The study starts with a review of the literature. This review draws from the entrepreneurial finance and corporate governance literature, relevant industry reports, and from the analysis of publications made by key opinion leaders. This is done on the premise that an understanding of the challenges of both sides of the table and the governance mechanisms put in place to align their potentially diverging interests is a *sine qua non* for a robust analysis of the investor-entrepreneur relationship. The second part of the study builds on twenty-one interviews with European venture capitalists and entrepreneurs.

Among the key results, this paper suggests that there is no 'one-size-fits-all' approach of venture capital activism and the effectiveness of the investor-investee relationship is not a function of the degree of involvement *per se*, but rather a function of the alignment on the expectations about the shape the investor-investee relationship will take at the post-investment stage. This paper ends with a proposal for investors and entrepreneurs. The proposal is an analytical tool (a four-quadrant matrix) providing the insights to find the sought after alignment on venture capital activism.

Keywords: venture capital, private equity, financing, entrepreneurship, shareholder activism, post-investment, corporate governance, agency theory, alignment.

(Dilbert by Scott Adams, Jan-1995)

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List of Abbreviations

- **AoA :** Articles of Association
- **AUM :** Assets Under Management
- **BA:** Business Angel
- **BoD**: Board of Directors
- **BVA:** Belgian Venture Capital & Private Equity Association
- **CAGR:** Compound Annual Growth Rate
- **CoC:** Cash-on-Cash Multiple
- **CVC:** Corporate Venture Capital
- **DCF:** Discounted Cash Flow
- **EU:** European Union
- **EV:** Enterprise Value
- **EVCA:** European Private Equity and Venture Capital Association, rebranded as Invest Europe
- **FFF:** Family, Friends and Fools
- **FTE:** Full-Time Equivalent
- **GIMV:** Gewestelijke Investeringsmaatschappij voor Vlaanderen
- **GP:** General Partner
- **ICO :** Initial Coin Offering
- **IPO:** Initial Public Offering
- **IRR:** Internal Rate of Return
- **LBO:** Leveraged Buyout
- **LP:** Limited Partner
- **LRM:** Limburgse Investeringsmaatschappij
- **M&A:** Mergers & Acquisitions
- **MBO:** Management Buyout
- **MRR:** Monthly Recurring Revenue
- **PE:** Private Equity
- **PME:** Public Market Equivalent
- **PMV:** ParticipatieMaatschappij Vlaanderen

- **SaaS:** Software as a Service
- **SME:** Small and Medium Enterprise
- **R&D:** Research & Development
- **SHA :** Shareholders' Agreement
- **SRIB:** Société Régionale d'Investissement de Bruxelles
- **SRIW:** Société Régionale d'Investissement de Wallonie
- **SFPI-FPIM:** Société Fédérale de Participations et d'Investissement-Federale Participatie en Investeringsmaatschappij
- **TAM:** Total Addressable Market
- **UK:** United Kingdom
- **USA:** United States of America
- **USP:** Unique Selling Proposition
- **VC:** Venture Capital / Venture Capitalist

Important Terminology

- **Assets Under Management:** Overall market value of assets managed on behalf of investors.
- **Bootstrapping:** A situation in which the entrepreneur starts and builds a venture from personal finances or from the venture's operating income, hence without external capital (Investopedia, 2018).
- **Business Angel:** A high net worth individual who invests part of his wealth in startups (Mason, 2006).
- **Buy-and-build strategy:** The strategy of a private equity firm buying a platform company and leveraging off this company to acquire subsequent tuck-in acquisitions, the idea behind this strategy is to increase the profitability of the group as a whole by leveraging the capabilities and synergies of each of these companies (Divestopodia, 2018).
- **Deal flow:** Pipeline of investment opportunities.
- **Dry Powder:** The amount of capital on hand kept by an investor for investment opportunities. This is the cash a VC firm has raised, but not deployed yet.
- **Enterprise Value:** Firm's value for all providers of capital, both debt and equity, thus, the entire economic value of the firm. A simplified formula: EV = market value of equity + market value of net debt.
- **Entrepreneur:** A term referring to one or multiple key manager(s), most of the time the founder(s) of the company in which venture capital / private equity funds invest (Guberna, 2015, p.3).
- **Governance Engineering:** The structuring and control of the boards of portfolio companies and above average involvement in governance to improve the performance of portfolio companies (Kaplan & Stromberg, 2008).
- **Homerun:** A successful investment that "*equals or outperform the entire rest of the fund combined"* (Thiel & Masters, 2014, p.59).
- **Operational Engineering:** The application of operating and industry expertise to improve the operating performance of portfolio companies (Kaplan & Stromberg, 2008).

- **Portfolio Company:** A company in which one or more venture capital / private equity providers are directly invested. An alternative term is an 'investee' company (Guberna, 2015, p.3).
- **Smart Money:** "*Smart Money investors bring cash and much more to the deal. Smart Money investors also bring knowledge and relationships that can accelerate the growth of a business and give it a competitive advantage*" (Davids, 2016, para.2).
- **Traction:** Tangible evidence of momentum in the market adoption of a startup's product or service. Metrics to measure traction can be the number of active users, website traffic, user engagement, growth, client retention, revenue, etc. (Barker, 2011).
- **Unicorn:** A startup valued at $1 billion or more.
- **Venture Capital funding rounds (seed, Series A, Series B, Series C and more):** A startup raises funding from venture capitalists in multiple rounds of financing tied to the startup's development stage, the level of risk for investors, the number of funding rounds already completed, and the purpose of the capital raised. The seed round is usually the first funding round, and each subsequent funding rounds has a letter attached to it, starting with Series A. Following a Series A comes the Series B, C and so on. Each round is seen as a stepping stone in the process of turning an idea into an enduring company (Lieu, 2018).

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Introduction

Fast-growing startups are widely associated with the venture capital (VC) industry (Burzacka & Gasiorowska, 2016; Davila et al., 2000). Entrepreneurial ventures in quest for growth often see the mere fact of raising venture capital funding as a sign of success (Paley & Flaherty, 2017). For these entrepreneurs, the millions raised are *de facto*, a barometer of performance (de Beaufort, 2018). All things considered, venture capital financing is for these companies an impetus to, *inter alia*, the recruitment of the right people, the investments in research & development (R&D), the investigation of new markets, *ipso facto*, the growth of the venture (Chan, 2007; Davila et al., 2000). Nowadays, policy-makers also realize that without access to sufficient funding, businesses cannot grow; thus, VC is acknowledged as one of the crucial levers for entrepreneurial companies' growth (European Commission, 2013).

As of writing (first half of 2018), the size of the VC industry[1] and the current momentum for entrepreneurship sparked the interest of a myriad of academics and policy-makers (e.g. Da Rin, Hellman & Puri, 2011; European Commission, 2012; Tirole et al., 2016). The literature is consequently well documented on several core topics related to VCs such as their decision-making process (e.g. Hudson & Evans, 2005), their internal firm organization (e.g. Gompers et al., 2016), their risk-return profile (e.g. Sahlman, 2010) or the determinants of their exit strategies (e.g. Gillain, 2016). Nevertheless, besides the mere provision of finance, the literature has identified a post-investment value-adding role for VCs (e.g. Hellman & Puri, 2002; Lerner, 1995). VCs are reputed to engage in a number of value-adding activities for portfolio companies such as BoD (Board of Directors) structuring & representation (i.e. governance engineering), recruitment, introductions to potential customers and suppliers, performance monitoring, assistance with strategic issues and operational engineering (Amornsiripanitch et al., 2016; Busenitz et al. 2004; Lerner, 1995; MacMillan et al., 1989; Seretakis, 2013). In addition, industry representatives stress the importance of this investors' hands-on approach. For example, the Belgian Venture Capital & Private Equity Association, emphasizes the importance of

[1] In 2017 €16,9 billion in venture capital was invested in European companies (Pitchbook, 2018)

VC activism, the investor being “more than just money” in its ten-point code of conduct with two points directly related to shareholder activism:

“[...] *2. Active involvement in the interest of the portfolio company*
This sustainable creation of value shall be realized through an active shareholdership with the portfolio company.
[...]
8. Monitoring and control
Members shall put in place mechanisms for internal and external monitoring and control, in their own organization and their portfolio companies.” (Manigart & Witmeur, 2012, p.12).

As a result, VC firms can be categorized as activist investors (Jackson et al., 2012; Kenney, 2000). This hands-on approach potentially represents a source of complementary skills and resources on top of the financial capital offered for entrepreneurs (Berg-Utby et al., 2007).

However, the positive perception on venture capital activism rests on increasingly shaky grounds. Berg-Utby et al. (2007) revealed that a gap exists between the entrepreneur’s expectation of VC’s value-adding activities and their achieved contribution once the investment is made, this gap might stem from the VCs overselling their activist stance and the suboptimal amount of time allocated to each venture by VCs with large portfolios. As explained in Jackson et al. (2012) study on venture capital activism, the involvement of VCs in portfolio companies has the potential to increase the investment returns, but the time and cost associated with the involvement dampen its positive impacts. Moreover, the outcomes of venture capital activism are ambiguous depending on the degree of activism (MacMillan et al., 1989). Besides, research suggests that approximately one-fifth of founders in venture-backed companies are replaced by their BoD (Ewens & Marx, 2018). For example, a power struggle at Uber, in 2018 the most valuable startup in the world[2], led in August 2017, Benchmark Capital, a VC firm, to sue Travis Kalanick, the then-CEO and co-founder of Uber (The Delaware Court of Chancery, 2017). In addition, investors can impose the wrong constraints and do not always offer the most judicious strategic input to portfolio companies (Busenitz et al., 2004). Likewise, for

[2] $68 billion according to Dow Jones VentureSource & The Wall Street Journal (2018)

Khosla (2013), VC's involvement can be a source of value destruction. These examples highlight the need of opening the black box of VC involvement in portfolio companies and the urgency of formulating a dedicated framework that would align VCs and entrepreneurs (De Clercq & Manigart, 2007; De Vlaminck & Sarens, 2014). Moreover, the majority of the research on the VC-entrepreneur post-investment relationship focuses on the US VC market, a market mature and larger than its European counterpart (Marovac, 2017), which might suggest improving, but still less sophisticated VCs on their approach toward entrepreneurs on this side of the Atlantic (Janz, 2018; Jeng & Wells, 2000). In addition, when reading about the potentially conflicting investor-entrepreneur relationship and the time spent by VCs in monitoring funded ventures (Gorman & Sahlman, 1989), the reader is left with two open questions: what is the right degree of VCs involvement in portfolio companies, and what are the mechanisms to put in place to guarantee an investor-entrepreneur relationship built for positive venture outcomes?

This paper studies the investor-investee relationship with the governance mechanisms ruling this relationship and venture capital activism as key underlyings. The envisioned output of this paper is to provide entrepreneurs and venture capitalists with a set of actionable recommendations for the stimulation of sound investor-investee dynamics.

The study focuses on the Belgian market with several insights from its neighbours, mainly France. In 2018, France is an interesting market because it is gradually becoming the dominant market for startups and venture capital in Europe, this trend is accelerating with the Brexit and the election of Emmanuel Macron in 2017 (figure 1, Atomico, 2017; Dealroom, 2017). While France is home to a few unicorns, such as BlaBlacar and OVH, Belgian unicorns are still nowhere to be found (Austin et al., 2015: CB Insights, 2018; Index, 2018). As a tangential point, understanding cross-border realities eases the promotion of an integrated European market which in turn foster more prosperous startups at the European level (European Commission, 2016).

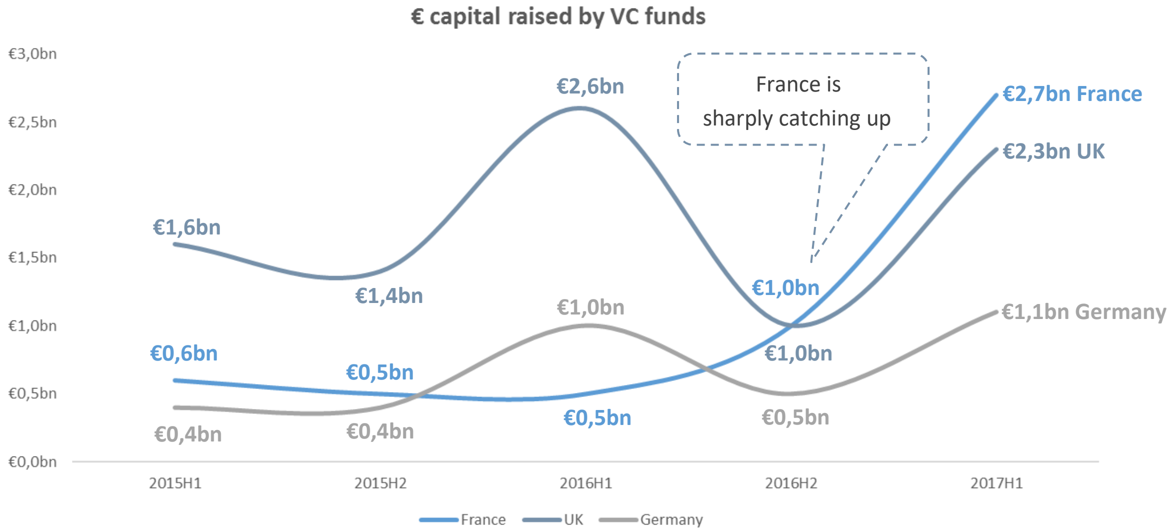

Figure 1: ***Fundraising by European VC funds*** *(Source: Dealroom, 2017, p.7)*

This paper is organized as follows. First, the relevant existing literature is reviewed. This review draws from the entrepreneurial finance and corporate governance literature, relevant industry reports, and from the analysis of publications made by key opinion leaders. More specifically, this literature review aims to introduce the reader to the different players involved and the customary corporate governance mechanisms put in place to align their interests and govern their relationship. The second part describes the empirical methods and data collected. The empirical analysis consists of 21 interviews with European venture capitalists and entrepreneurs. Third, the findings and related discussions resulting from the empirical analysis are reported. Fourth, the recommendations for entrepreneurs and investors are drawn. This paper comes to an end with overall remarks, limitations and related avenues for future research.

Part One: Theoretical Framework – Setting the Landscape

1 What is a Startup?

A thorough understanding of the challenges of both sides of the table (venture capitalists and startup entrepreneurs) and the governance mechanisms put in place to align their sometimes diverging interests is a *sine qua non* for a robust analysis of the investor-entrepreneur relationship. This first part starts with a discussion on what is startup, a trendy term covering different realities for different people.

1.1 A Misused Term

"I am […] tired of the word startup. It seems like everyone and their mother has a startup today, I might even start calling the […] grocery store next doors a food startup." This response on a Netocratic (Kiska, 2014, para.1) article reflects the problem with the concept of startup, it is overused to the point of becoming meaningless for some (Golden, 2017). One might accordingly wonder, what is a startup?

For Blank (2010, para.2) "*a startup is a temporary organization used to search for a repeatable and scalable business model*." Graham (2012, para.1) adds some colour to this definition, a startup is "*a company designed to grow fast*". According to Fridenson (2015, cited by de Chevigny, 2015, para. 4), "*It is neither age, size nor sector of activity that make a company a startup, but the following conditions: the prospect of strong growth, the use of technology and the need of substantial financing through fundraising. It was with the appearance of the first venture capital companies in 1946 that the term began to be used on a massive scale."* According to Rudelle (2015, para.3), "*a startup is a company built for growth*". For the Agence du Numérique (i.e. Digital Wallonia, 2018), a startup is a "*young company developing an innovative digital solution and aiming for strong growth. To support this growth, it often needs to be financed by external capital."* For Golden, (2016, para.8) startups are *"innovative & unproven, young technology companies, needing money for ambitious, but credible growth plans"*. These six definitions provide the four criteria used to identify a startup in this paper:

- a strong growth potential
- a scalable and repeatable business model
- a distinctive use of technology
- the high funding requirements

With these criteria in mind, the obvious can be stated: not every young company is a startup; restaurants, barbershops, cafés, etc., are not startups (Graham, 2012). One cautionary note: the definition of startups used in this paper encompasses the concept of scaleups as well; this is a simplifying assumption as many practitioners (e.g. EY, 2018; Millers & Friesen, 1984; Moore, 1991; Onetti, 2014) make a clear distinction between startups and scaleups on the basis of the maturity phase of the firm.

1.1.1 A Strong Growth Potential

According to Graham (2012), the European Commission (2016) and Rudelle (2015), startups and growth are two intermingled concepts. Startups potentially address a large market and to come back to Blank's definition (2010), are scalable, meaning they have the potential to address this larger market with minimal margin erosion (Bresson, 2018). In addition, a large body of literature on VC designates growth as a key investment criterion (Boocock & Woods, 1997; Kaplan & Stromberg, 2004; Kenney & Zysman, 2018; Martel, 2006 Muzyka, Birley & Leleux, 1996; Zacharakis & Meyer, 2000). Rothman (2016) characterizes growth as a priority for startups: sustainable growth is a positive signal of a startup's long-term potential and the bulk of a startup's value lies in its potential future growth and profitability (Damodaran, 2009). Lastly, McKinsey & Co (2014) found out that growth has a paramount importance for startups as growth yields greater return, predicts long-term success and matters more than margin or structure.

Given these considerations, it is essential to specify what is considered as strong or high growth; a high-growth company has an annualized growth rate in terms of revenue or employees greater than 20% *per annum* (Eurostat & OECD, 2008).

1.1.2 A Scalable and Repeatable Business Model

There is no generally accepted definition of the term 'business model' (Shafer et al., 2005). However, this paper builds upon, Osterwalder & Pigneur (2010, p.1) definition: "*a business model describes the rationale of how an organization creates, delivers and captures value*." A scalable business model can easily be expanded and grow its recurring revenue significantly with unit costs declining. The concept of scalability is closely related to the economies of scale concept, where a particular set of firms is able to profitably swell with a cost advantage (Abate et al., 2009). A startup is "***<u>in search</u>*** *for a repeatable and scalable business model*" (Blank, 2010, para.2), this means that contrary to an established company's business model, a startup's business model can still be subject to iterations to improve product-market fit (Ries, 2011). A company like PayPal had to go through five different business models in its early days before getting to the one that worked (Thiel et al., 2011). Porré et al. (2018, p. 5) identify nine common business models in the European startup ecosystem:

- Subscription: SaaS and licensing models with revenue made on a recurring basis
- Commission/marketplace: platform charging a fee for intermediated transactions
- Performance: "*built around usage from a recurring user community*"
- eCommerce: buy and resale of goods online with stock management and margins as key challenges
- Manufacturing: production of merchandise resulting in finished goods to be sold
- Retail: brick-and-mortar resale of goods
- Audience: "*traffic-based revenue*"
- Services: "*margin between labour cost and service invoice price*"
- Research: "*strong R&D focus to keep high barriers to entry*"

In 2017, subscription based models and marketplaces were the most frequent business models in Europe (63% of all business models in the ecosystem) (Mohout, 2018).

1.1.3 A Distinctive Use of Technology

Contrary to popular belief, startups are not all about technology (Colin, 2017). What makes the difference for startups is how they use technology. Their use of technology is the lever of three phenomena:

- increasing returns to scale
- the collection of data from its users/customers
- exceptional customer/user experience

For startups, "*there is no tradeoff between quality (exceptional experience) and scale (increasing returns)"* (Brian Arthur, 1996; Colin 2017, para.9; Nivi, 2013). The collection of data is the bridge between the increasing returns and the exceptional user experience.

Besides, technology is a catalyst of scalability and decreases the barriers of new ventures creation (Kenney & Zysman, 2018).

1.1.4 The High Funding Requirements

Startups, especially in their early-stage are often characterized by small or non-existent revenue, operating losses and negative earnings (Damodaran, 2009; Leonetti, 2016), this situation drives the need for funding. In addition, even profitable startups need funding as this is for them a way to invest in technologies, products, and human capital and to drive scale and growth (Kenney & Zysman, 2018; Rothman, 2016). Madhvani et al. (2018, p.13) agree with Rothman, access to capital is critical to drive growth and to scale, and without an increasing ability to attract capital investments, European startups "*will never catch up with their American and Asian competitors*". Frédéric Mazzella, BlaBlacar CEO, made a similar point:

"By definition a startup isn't profitable, otherwise it wouldn't need to raise funds from venture capitalists! We raised 100 million dollars to expand our operations globally. There are three steps in the life of a company: viability, profitability and expansion. We proved the viability of our business model: if we operated only in France today, we'd be profitable. But given the speed at which things are going today, if we aimed for profitability before international expansion, all the marketplaces would be snatched from us. So we swapped the steps and decided to aim for (expensive) expansion before profitability. We are scaling up right after starting up, which isn't very common in France." (Mazzella, 2014, para.4)

Startups' funding alternatives can be classed into four categories: (i) debt, (ii) equity, (iii) subsidies & grants and (iv) hybrids (Government of Flanders, 2018).

1.1.4.1 Debt

Startups can receive a loan from their first circle, the Family, Friends & Fools (FFF). Startups can also apply for a bank loan, however, the nature of early-stage startups (limited financial track-record, operating losses, lack of tangible assets) makes banks reluctant to lend money (Gompers & Lerner, 1998; Murray, 2018). Other options for debt remain government loans and debt-based crowdfunding (Belleflamme et al., 2014).

1.1.4.2 Equity

The first equity source for startups are the founders themselves. This initial equity injection is a positive sign for external capital providers, it exhibits commitment from the founding team (Manigart & Witmeur, 2012) and raising external equity is not a *sine qua non* for success: there are many examples of startups (e.g. Github, Survey Monkey) that found success as bootstrapped companies. However, most of them have taken VC funding down the road to scale. FFF can also contribute as equity investors. The most discussed form of equity funding is risk capital providers: Business Angels (BA) and VCs. As illustrated in figure 2, BAs invest at the very early-stage and bridge the gap between FFF and the first professional investors, the VCs (Manigart & Witmeur, 2012; Tirole et al., 2016). Startups can also raise equity through equity-based crowdfunding platforms (Belleflamme et al., 2014). Later stage startups can afford equity raise through public markets (i.e. Initial Public Offering, IPO).

1.1.4.3 Subsidies

Several governmental incentives exist to foster entrepreneurship, startups growth and job creation. For example, the three Regions of Belgium and Bpifrance (a French governmental agency) offer various support measures to startups (Federal Government of Belgium, 2018; Leonetti, 2016).

1.1.4.4 Hybrid Securities

There is one additional category, hybrid securities: this asset class combines features of both debt and equity. Hybrid securities often used by VCs are the convertible debt and preferred stock. The first is a type of debt security that provides the bondholder or the issuer the option to convert the security into a predetermined amount of equity. The latter is a class of ownership senior to common stock, but junior to debt and has a higher priority to common stock in terms of earnings and usually in the distribution of assets upon liquidation (ASX, 2018; Investopedia, 2018; Schmidt, 2003).

1.1.4.5 Additional Considerations

In parallel to the discussed primary sources of capital, academics have identified innovative funding sources. This paper does not touch upon all of them but needs to at least briefly address one of these innovative funding sources that readers should keep in mind. Initial Coin Offerings (ICOs) is one of these novel forms of new venture financing (Catalini & Gans, 2018; Kenney & Zysman, 2018). An ICO is a fundraising mechanism where the issuer sells token in exchange for cryptocurrencies (e.g. Bitcoin, Ether, and Ripple). Tokens are "*digital coupons issued on an indelible distributed ledger, or blockchain, of the kind that underpins bitcoin, a cryptocurrency. That means they can easily be traded, although unlike shares they do not confer ownership rights. Instead, they often serve as the currency for the project they finance [...] Investors hope that successful projects will cause tokens' value to rise.*" (The Economist, 2017, para.3). Issuers willing to do an ICO publish a white paper (equivalent to a prospectus) and make their roadshow on social media. In 2017, around $7 billion has been raised by startups through ICOs with over 200 ICOs above $10 million (Catalini & Gans, 2018).

Despite the various sources of funding, startups often face the 'equity gap'. This problem occurs when the funding need is too high for a BA, but too low for a VC willing to invest in larger projects. Crossing this 'Death Valley' can be a difficult phase for startups as this is a phase were numerous early-stage startups fail (figure 2; Manigart & Witmeur, 2012; Zimmern, 2012).

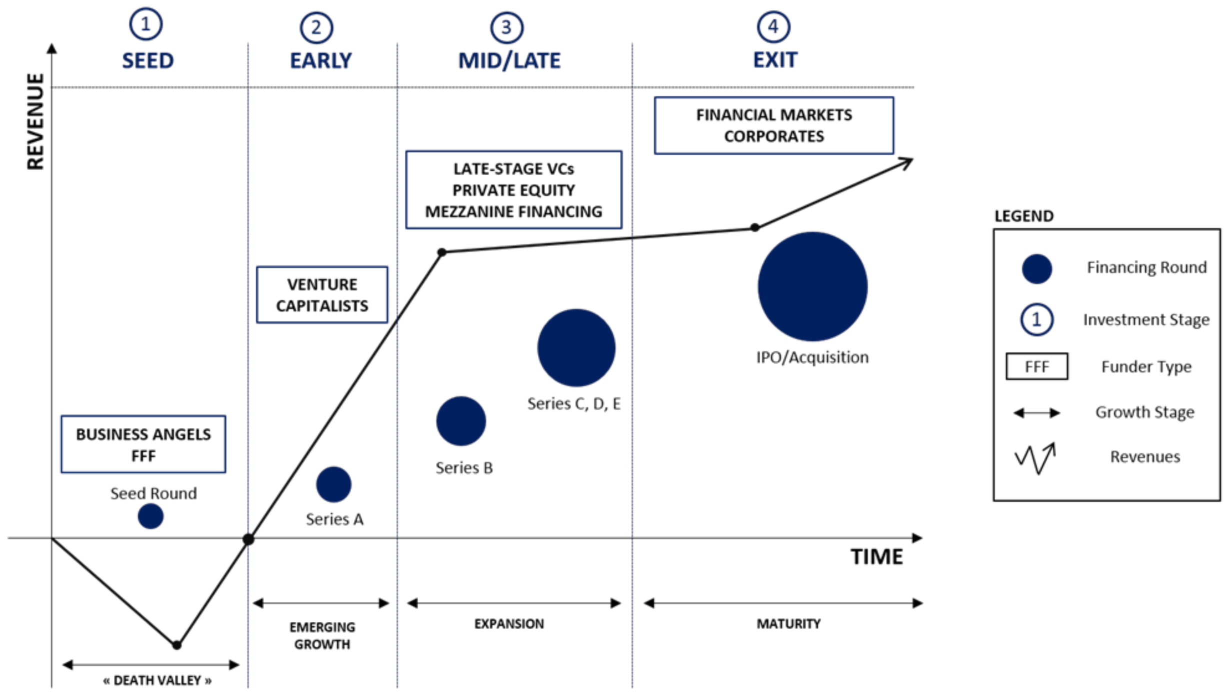

Figure 2: ***Usual startup financing cycle*** *(Source: Tanaka & Proux, 2016, p.8)*

1.2 Key Learnings

It became manifest with this section that a startup is a firm with specific challenges at hearth: growth, scalability and a heavy reliance on technology; all of this driving high funding needs. The subsequent section brings some perspective on the other side of the table: the venture capitalists; these players can provide funds and be instrumental in turning a high-potential startup into an enduring company (Gompers & Lerner, 1998; Silveira & Wright, 2006).

2 The Venture Capital Industry

By defining what a startup is, the previous section delimited this thesis' subject and built the foundation to have a better understanding of a startup's challenges. This section puts the spotlight on the VC industry. The background of the VC firms are covered, their impact, their role in backing young fast-growing firms, how they work and their performance.

2.1 Introduction to Venture Capital and Private Equity in Belgium

VC is a subset of a larger investment class, private equity (PE). The three major categories of PEs are venture capital, development/growth capital, and buyouts. These categories depend on the target firm's development stage (ECVA, 2009; Jongbloed & Dewaelheyns, 2017).

- ❖ VC funds target young ventures for minority stakes (Bain & Company, 2017; Gompers & Lerner, 2001). Practitioners further subdivide VC firms into (i) seed (i.e. support of the pre-marketing stage of the startup with an emphasis on the proof-of-concept development), (ii) early-stage (i.e. support of the sales & marketing engine with an emphasis on customer acquisition) and (iii) later-stage (i.e. support of the expansion and scale with the possibility to pursue external growth opportunities). (EVCA & Thomson Reuters, 2014; National Science Foundation, 2018). The ranking of Europe's most prominent VCs in 2018 is available in appendix 1.
- ❖ Growth capital funds come in a later stage and are dedicated to supporting the expansion of target firms, these funds often take minority stakes (EVCA, 2009).
- ❖ Buyouts funds target mature and stable industries with steady cash flows (Bain & Company, 2017). Whereas VC and growth capital funds take minority stakes in firms, buyout funds take control of their targets. This type of transaction is financed using a small level of equity and a high level of debt (Yates & Hinchliffe, 2010), hence the term of leveraged buyout (LBO). Landmark LBOs include the $31,1 billion takeover of RJR Nabisco by the PE fund KKR and Blackstone's acquisition of the Hilton Hotels for $26 billion (Burrough & Helyar, 1989; Thomson Reuter, 2013). The largest buyout funds worldwide in 2018, by assets under management (AUM), are The Carlyle Group, Blackstone, KKR, Apollo Global Management and CVC Capital Partners (Private Equity International, 2018). Except for CVC Capital Partners, these firms are all US-based.

2.1.1 The Belgian Private Equity Landscape

Belgium is subject to PE activity. A large number of PE firms are active in Belgium (figure 3).

Figure 3: ***Overview of the Belgian Private Equity landscape*** *(Note: non exhaustive; Source: Mergermarket, 2018; author's construction)*

The most active PE firms in Belgium in terms of number of investments in 2015-2018 are Gimv, Waterland and Bencis Capital Partners (figure 4).

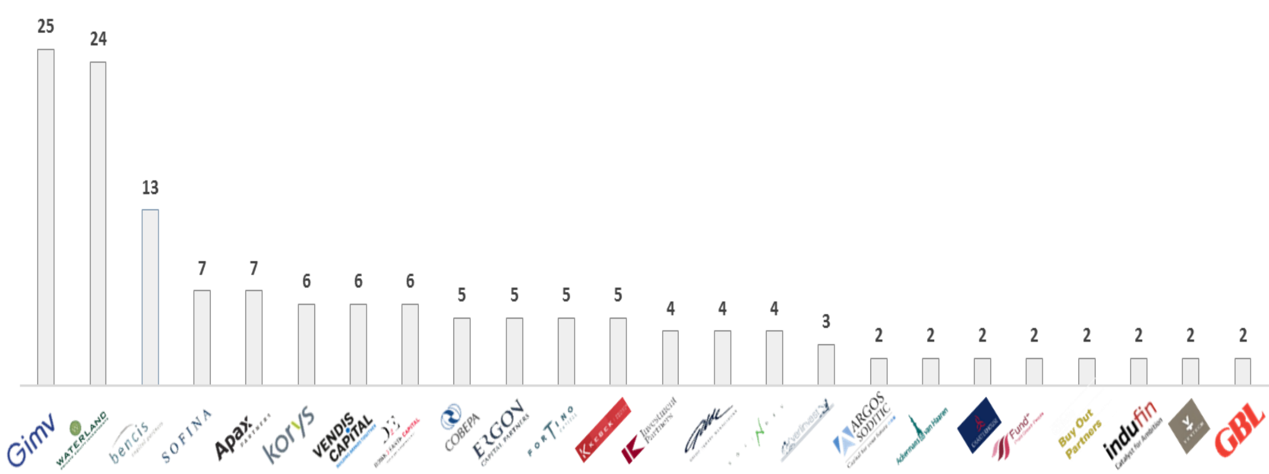

Figure 4: ***Most active Private Equity players in Belgium by n° of deals since Jan-15 - Entries*** *(Source: Mergermarket, 2018; author's construction)*

2016 has been an *annus mirabilis* for PE in Belgium with a number of transactions reaching an all-time high for the decade (figure 5). A sharp decrease in the number of deals has been observed in 2007-2009 following the financial crisis. The decrease in entries is mainly due to the credit crunch making it difficult to access debt financing and uncertain political/financial outlook frightening investors. Overall, the proportion of entries, exits and secondary buyouts remains fairly constant over time. The number of entry transactions is constantly higher due to, *inter alia,* the buy-and-build strategy of many PE funds. According to Roland Berger (2018), about half of the M&A professionals expects the number of transactions with PE involvement in Europe to increase in 2018.

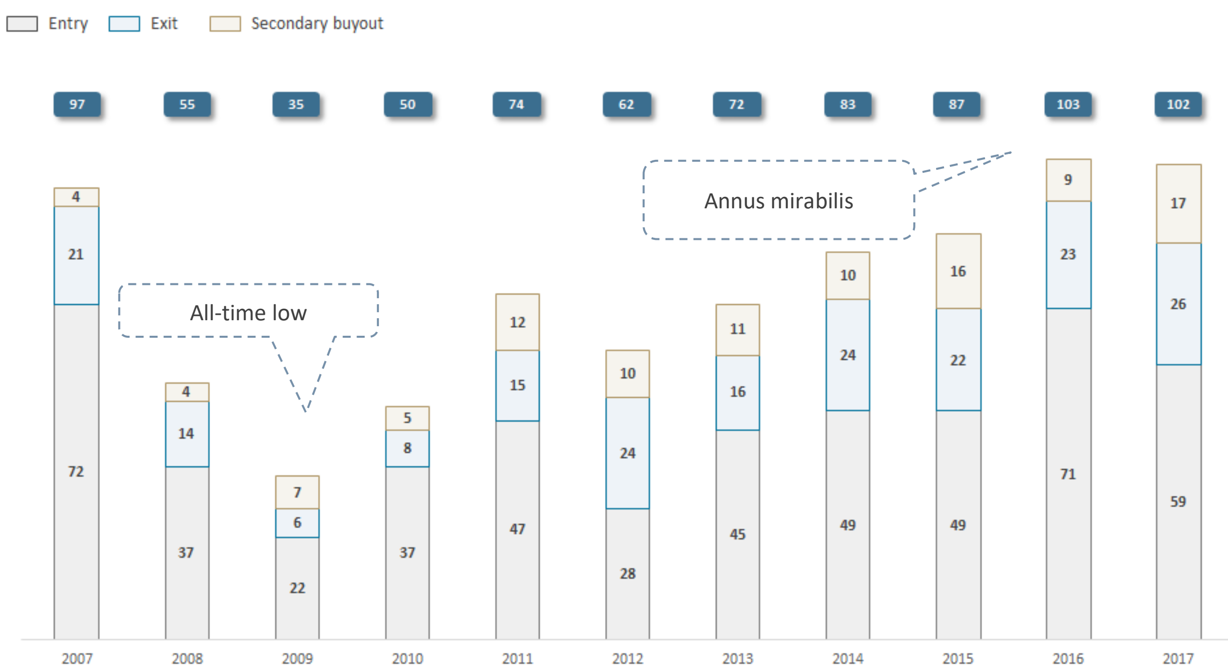

Figure 5: ***Total number of Private Equity transactions over the last ten years in Belgium (entry, exit or secondary buyout)*** *(Source: Mergermarket, 2018; author's construction)*

2.2 The Impact of Venture Capital

Startups funding contributes to economic growth and job creation (European Commission, 2016; Gilson, 2003; Seretakis 2013). Kortum & Lerner (2000) studied the relationship between VC and patents productions, they found out that VC-backed firms were more effective in delivering innovation than non-VC-backed firms. As specified by Frontier Economics (2013, p.6), "*innovation supports improvements in productivity, which* *in turn improves competitiveness*", these variables are levers to economic growth (European Commission, 2011). Regarding job creation, VC investments foster entrepreneurship (Popov & Roosenboom, 2009) and new business creation contribute to higher employment. Moreover, VC-backed startups have a higher chance of survival than non-VC-backed startups (Ber & Yafeh, 2007). In addition, on the date of the 14th of June 2018, the largest companies worldwide, by market capitalization (Apple, Amazon, Google/Alphabet, Microsoft, and Facebook – the GAFAM; Bloomberg Terminal, 2018) have all been VC-backed one day (Accel Partners, 2018; Crunchbase, 2018; Kleiner Perkins, 2018; Sequoia Capital, 2018). These companies are among the most innovative companies worldwide (The Boston Consulting Group, 2018) and Apple is the first U.S. listed firm to achieve the symbolic milestone of a market capitalization of $1 trillion (The Wall Street Journal, 2018). Following a study by Dealroom (2018), between 1998 and the first half of 2018, 63% of all European companies valued in excess of $1 billion were venture-backed. This trend is accelerating: 92% of the companies that reached a $1billion and more valuation in the first half of 2018 were venture-backed (figure 6). All in all, when done right, VC can have a tremendous impact by "*supporting technological development and earning outstanding returns for investors."* (Thiel et al., 2011, p.1).

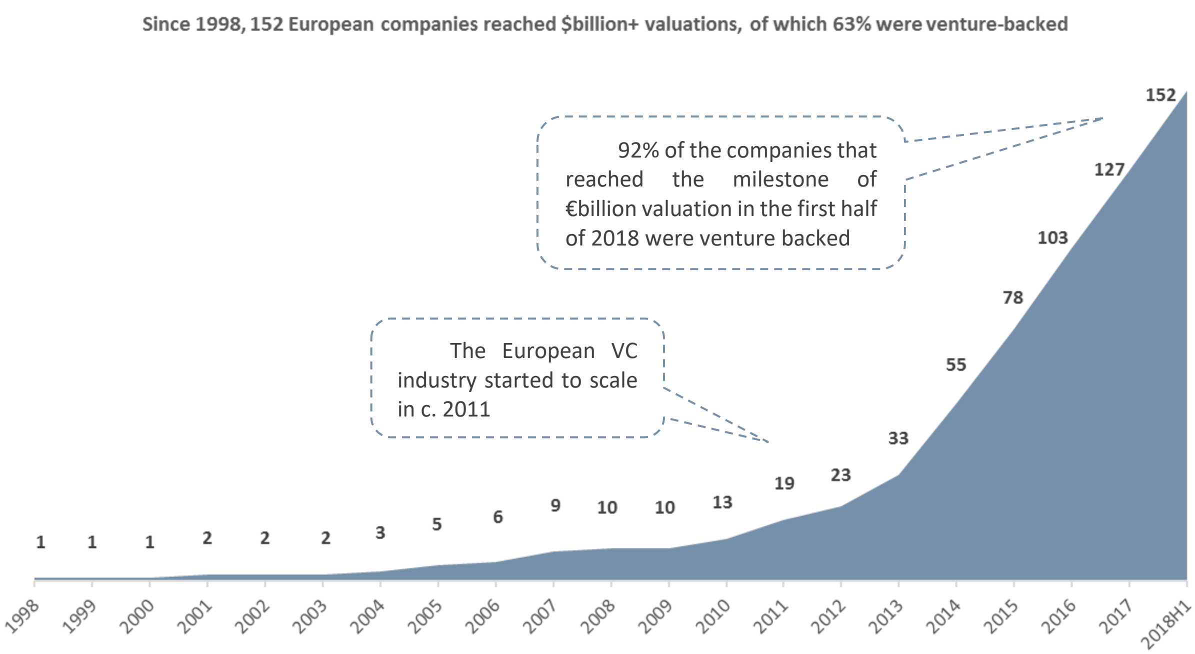

Figure 6: ***Total number of European companies valued over $1 billion*** *(Source: Dealroom, 2018, p.22)*

As of writing (first half of 2018), the latest data available illustrate VC investments still accounting for less than 1% of the European Union's gross domestic product (Eurostat, 2016; OECD, 2017). That being said, VC firms were involved in 3.306 investment rounds in 2017 (figure 7). The amount of VC deals grew at the double-digit growth rate of 14% in 2008-2017 and the aggregate value of capital invested reached €16,9 billion in 2017 which is a decade high level; these trends coupled with investments per capita still 8x lower than in the US, illustrates growth opportunity for the VC industry in Europe (Dealroom, 2018; Pitchbook, 2018). The growth of the European VC industry and the abundance of dry power on the global scene (figure 8) intensifies the competition between VCs for the investment opportunities available (Pitchbook, 2018).

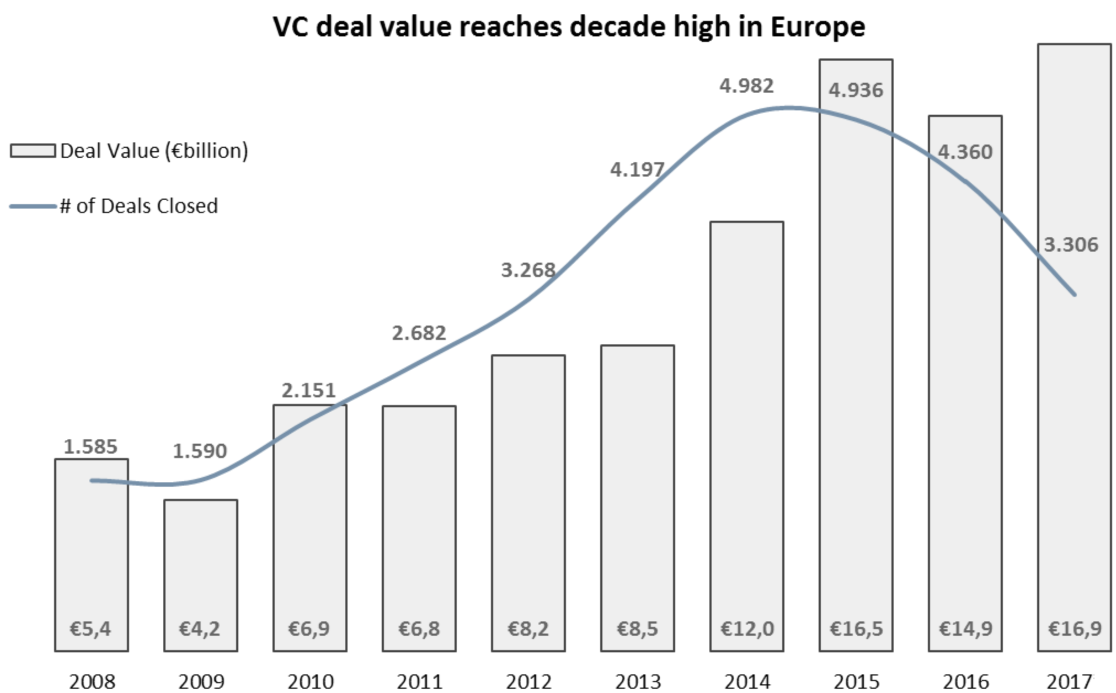

Figure 7: ***VC activity in Europe: number European VC investment rounds and aggregate deal value*** *(Source: Pitchbook, 2018, p.3)*

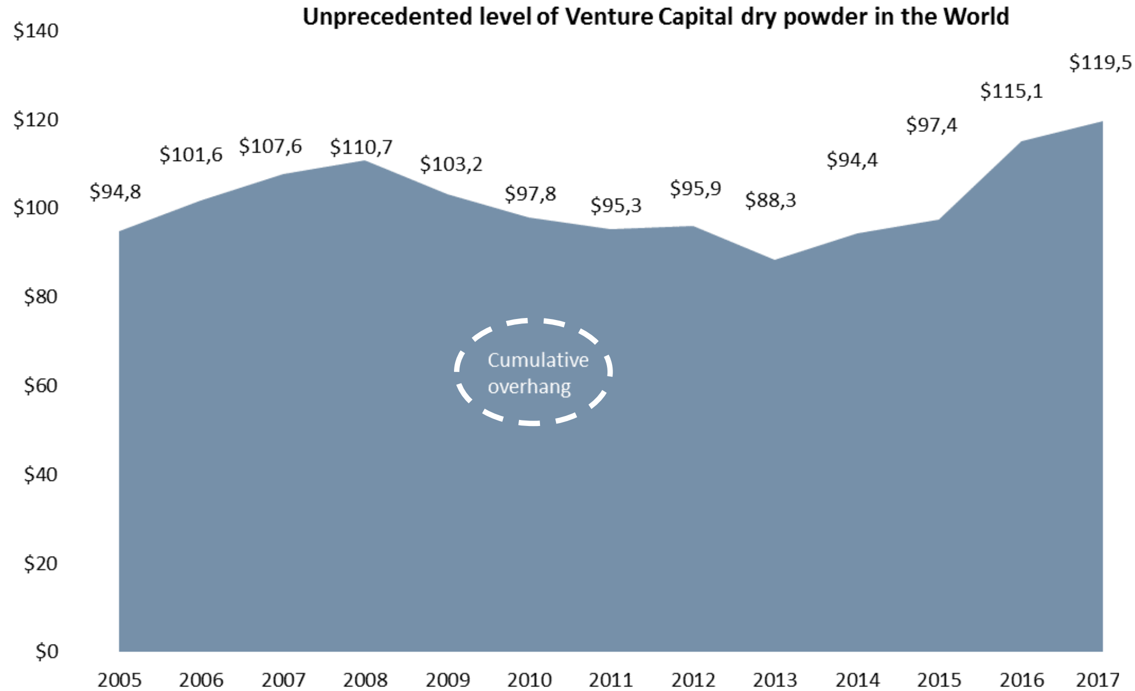

Figure 8: ***Global venture capital dry powder ($billion) per year*** *(Source: Pitchbook, 2018, p.6)*

2.3 The Belgian Venture Capital Landscape

In Belgium, the lion's share of the venture capital's supply is captured by Flanders with most of the funds located in the north of the nation when it is not Brussels (DataScouts & Startups.be, 2018; Febelfin, 2014), nonetheless, except pure regional VCs (e.g. LRM, SRIB), Belgians VCs target the whole Belgian territory in terms of geographics. According to Febelfin (2015), the supply of VC is sufficient in Belgium in terms of volume, but fragmented restricting the market's maturity. Belgian startups willing to raise later stage financing often work with foreign VCs. Adapting Tykvova et al. (2012) methodology to Belgium, four major VC categories are identified in the territory (table 1). At the European level, 55% of the VCs are plain vanilla (i.e. independent), 26% are corporate-related (CVC) and 19% are governmental agencies (Tykvova et al., 2012).

Type	Description	Examples
Vanilla VC	Classic VC and PE firm with a dedicated VC team	FORTINO CAPITAL, VOLTA VENTURES, Gimv
Corporate VC	VC firm founded and operated by an established corporation	SOLVAY, proximus, Belfius
Government & university-run VC	VC firm founded and operated by the government or attached to a university	PMV, SRIW, finance.brussels
Foreign VC	International VC firm active in Belgium	kima ventures, partech, Index Ventures

Table 1: ***Belgian Venture Capitalists typology*** *(Source: author's construction)*

In 2017, the most active VC investors by the deal count in France and the Benelux have been Bpifrance (French government), Angelsquare and Kima Ventures (see figure 9). Note that these players are all French. For Tirole et al. (2016), the prevalence of a governmental agency like Bpifrance in direct investments, notwithstanding its pivotal fund-of-funds activity, should be questioned.

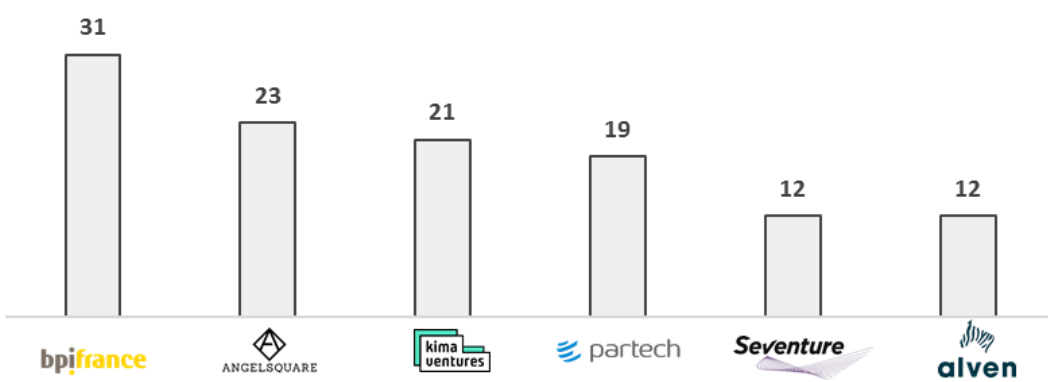

Figure 9: ***Most active VCs by deal count in France & Benelux 2017*** *(Source: Bpifrance, 2018, https://www.bpifrance.fr/A-la-une/Actualites/Bilan-d-activite-2017-un-grand-millesime-38945; Pitchbook, 2018, p.19)*

2.4 The Structure of Venture Capital Organizations

VC firms are conventionally managed by General Partners (GPs). GPs collect capital from investors, the Limited Partners (LPs). These LPs traditionally are institutional investors, such as sovereign wealth funds, pension funds, fund-of-funds, insurance companies, endowment funds, mutual funds, corporations, banks, governments as well as wealthy individuals and family offices (Seretakis, 2013; Tirole et al., 2016; Xu, 2004). Examples of European LPs include Bpifrance, SFPI-FPIM, European Investment Fund, Société Générale, Finnish Industry Investment, and Nokia. LPs invest in VC funds and other alternative investments to achieve diversification, for their lower correlation with other asset classes, acyclicality, and their expected high risk & return profile (Blackrock, 2018; Hadzima, 2012; Sorensen et al., 2013; Thiel et al., 2011). In addition to these financial motives, some LPs are involved in VC to support innovation and entrepreneurship (e.g. Bpifrance and the European Investment Fund). In order to align LPs and GPs' interests, GPs often contribute to 1% of the fund capital (Kaplan & Stromberg, 2008). LPs are passive investors, they are not involved in the fund management, GPs are the ones responsible for making investment decisions and managing the fund's portfolio (Da Rin et al., 2013). In 2017, VC funds have secured $42 billion in committed capital (Pitchbook, 2018, p.2). VC funds usually have a fixed lifespan of ten to twelve years. This feature forces GPs to regularly collect fresh capital from LPs (every three years on average; Friend, 2015; Rachleff, 2014). The fund's life can be divided into two parts: (i) the investment period lasting three to five years where the GPs make investment decisions and deploy capital into companies, (ii) the harvesting period lasting the next five to seven years where the GPs manage and exit the investments (Seretakis, 2013), these liquidity events enable the GPs to return capital to LPs.

GPs are customarily compensated by charging a 2% management fee on the AUM. Besides, if the fund's performance exceeds the minimum required rate of return for the LPs called the hurdle rate (around 8% (Smith et al., 2011)), the GPs takes a 20% fee, the carried interests, of the fund's profit (Fleischer, 2008; Lerner et al., 2007). With the 2% management fee, the 20% carried interests and the GP's 1% contribution into the capital, the funds' rule of thumb becomes “2/20/1” (Robinson & Sensoy, 2013). The GP/LP model is outlined in figure 10.

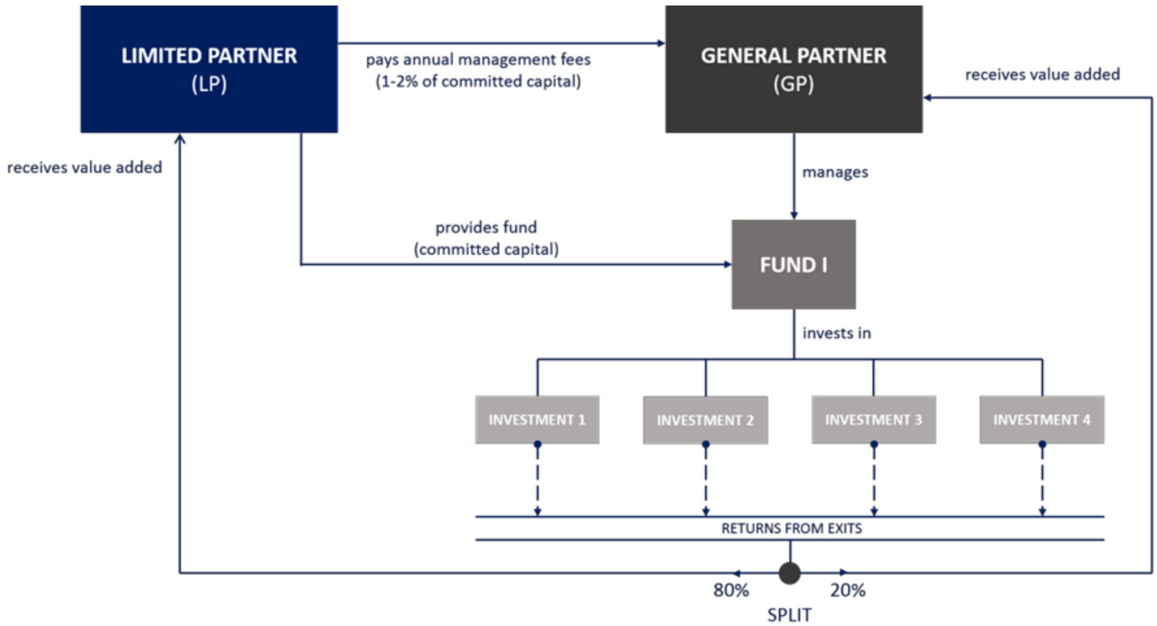

Figure 10: ***GP/LP model*** *(Source: Tanaka & Proux, 2016, p.9)*

In terms of personnel, the traditional VC firm is a lean organization characterized by an upside-down pyramid with an investment team dominated by senior GPs outnumbering junior personnel (Wasserman, 2005). Later stage funds tend to have a larger team as target companies require heavier due diligence than early-stage startups (Gompers et al., 2016). The vast majority of U.S. GPs are graduates from top-tier universities (on par with Harvard, Stanford, Wharton and the likes) and have a career background in corporate management, banking/finance or entrepreneurship (Smart et al., 2000). In terms of background, junior team members (Analysts and Associates) usually have a strong academic backgrounds (e.g. tier 1 schools like HEC Paris, ESCP, l'Ecole Polytechnique for French VCs) and have previously worked up to three years in technology, consulting, investment banking or a startup (Rogers, 2009; Suster, 2010; Userovici, 2018).

2.5 The Venture Capitalist's Investment Cycle

Academics and industry professionals have sought to better understand what VC firms do, what they look for and their performance (e.g. Gompers et al., 2016; Hege, Palomino & Schwienbacher, 2003; Kaplan & Stromberg, 2000; Silveira & Wright, 2016; Šimić, 2015).

For entrepreneurs, a careful understanding of the VC's investment cycle eases the access to VC funding (Hall & Hofer, 1993).

Academics consider the VC investment cycle as a multi-staged process (Hall & Hofer, 1993; Silver, 1985; Smith et al., 2011; Tyebjee & Bruno, 1984). Hudson & Evans (2005, pp.3-4) have identified the following stages: (i) "*deal generation*", (ii) "*initial screening*", (iii) "*project evaluation and due diligence*", (iv) "*deal structuring*", (v) "*post-investment activities*", and (vi) "*cashing out or exit activities*".

2.5.1 Deal Generation

The first responsibility of the GP is to generate a deal flow for the fund. Gompers et al. (2016) explain that a VC fund is usually not a generalist and tend to specialize on a basis of several criteria (e.g. industry focus, geographics, and stage of the startup development). VC firms, therefore, have a clear focus in terms of deal flow. Having a high-grade deal flow is crucial for VCs as it allows them to attract the most promising entrepreneurs and secure more high-potential deals, therefore, boosting their overall performance (Gompers et al., 2016). For Dixon (2017, para.17), "*success in VC is 10% about picking, and 90% about sourcing the right deals and having entrepreneurs choose your firm as a partner*". This creates a compelling argument for VCs to build their reputation and grow brand awareness. VCs dedicate a considerable amount of time to deal sourcing activities (Gompers et al., 2016; Userovici, 2018).

2.5.2 Initial Screening

Once the deal flow is created, the VC makes a preliminary evaluation of the investment opportunity. This preliminary stage does not involve a full-blown due diligence of the opportunity and limits itself in reading the investment opportunity's executive summary or business plan to decide if the opportunity worth a closer evaluation. This screening process is a 'Go/No go' type of decision and takes less than twenty-one minutes on average (Hall & Hofer 1993; Hudson & Evans, 2005).

A large body of research has focused on identifying a list of objective factors used by VC firms to discriminate on investment proposals (e.g. Gompers et al., 2016; Kaplan & Stromberg, 2000; Šimić, 2015; Tyebjee & Bruno 1984). There is a low convergence level among the researchers' findings (Hudson & Evans, 2005). This suggests that although the VC decision-making process is fact-based, it can become much "*more an art than science*" (Hudson & Evans, 2005, p.6). That being said, Hudson & Evans (2005, p.6) have identified six factors making the consensus among academics: (i) "*management skill and experience*", (ii) "*the venture team*"; (iii) "*product attributes*", (iv) "*market size*", (v) "*market growth*", and (vi) "*expected return on investment*".

In 2018, Coppey (2018) has screened a dozen of VCs' investment principles and came up with a 5-Ts decision-making framework: (i) Team, (ii) Tech (i.e. the product), (iii) Total addressable market (i.e. the market), (iv) Traction (i.e. the growth), and (v) Trenches (i.e. a defensible competitive advantage).

As a rule of thumb, VCs aim for deals with the potential of returning 10x the money invested at the time of exit (Rachleff, 2014).

2.5.3 Evaluation and Due Diligence

This step involves "*a greater scrutiny of the business plan*" (Hudson & Evans, 2005, p. 4) and an in-depth due diligence review of the investment opportunity. The criteria used during the evaluation phase are the same as during the screening phase with a deeper degree of analysis and a special emphasis on the risks. See appendix 2 for a standard due diligence check-list.

2.5.4 Deal Structuring

Once the VC firm has decided to invest in a particular project, the deal has to be structured. The structuring revolves around two key considerations: (i) the valuation of the startup and (ii) the legal agreement that governs the terms and conditions of the deal.

These elements are outlined in a document called a ‘term sheet’ (Hudson & Evans, 2005; Manigart & Witmeur, 2012).

2.5.5 Post-investment Activities

“*The relationship between the entrepreneur and the VC does not stop at the point of investment”* (Manigart & Witmeur, 2012, p.33). At this stage, the VC is supposed to bring ‘added value’ through its involvement with the investee’s business to ensure their optimal development (Hudson & Evans, 2005). This often comes into the form of spending time to monitoring and advising the startup’s management on strategic and financial matters. Some more hands-on VCs go one step further and are involved in operational engineering. Furthermore, a VC is often involved in the startup’s BoD (i.e. governance engineering). A VC spends on average 18 hours per week with portfolio companies (Gompers et al., 2016).

2.5.6 Cash-Out or Exit Activities

This step represents the end of the VC-entrepreneur relationship. This is the liquidity event for the investor. The four major exit routes are (i) trade sale − the sale of the portfolio company to another company, (ii) Management Buyout (MBO) − the purchase of the business by the company’s management team, (iii) IPO − the launch of the company on the public stock market, (iv) secondary sale − the sale of the company to a financial sponsor (Manigart & Witmeur, 2012). In Europe, the majority of the companies use M&A as exits option (figure 11). 4.48x is the median EV/Sales paid by acquirers between 2015 and 2017 in Europe (Porré et al., 2018). In the first half of 2018, the most meaningful VC-backed exits in Europe were Spotify (€24 billion IPO), Adyen (€7 billion IPO) and iZettle (acquisition by PayPal for €2 billion) (Dealroom, 2018).

A favourable exit market is fundamental because it creates a positive feedback loop on the early stages of the financing chain (Tirole et al., 2016). In the US, this positive feedback chain is characterized by successful entrepreneurs who tend to reinvest part of their gains in other companies, thus becoming business angels and creating a multiplier effect; not only, they provide capital, but also entrepreneurial expertise (Gompers et al., 2010). Having said that, not all VC-entrepreneur stories have a happy ending (e.g. Take Eat Easy) and some investments simply are written-off by the VC (Gillain, 2016).

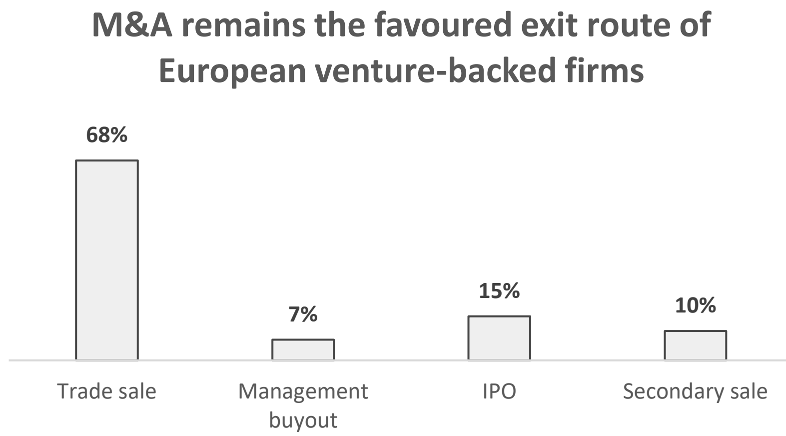

Figure 11: ***Distribution of European VC-backed exits in 2017*** *(Source: Dealroom, 2018, p.36; author's analysis)*

2.6 How to Evaluate Venture Capitalists?

Discussing VC performance is a challenging endeavour as VC performance data are sensitive (Hege, Palomino & Schwienbacher, 2003). Most researchers have studied VC funds' performance using one of the two following methods: (i) hand-collected data (through questionnaire or interviews directly with VC firms) (e.g. Krieger et al., 2012) or (ii) data from various databases. However, both methodologies suffer from two potential biases:

- The survivorship bias: simply put, the survivorship bias occurs when the researcher makes a performance study and excludes failed companies from the sample because they do not exist anymore, these excluded companies were the underperformers in the sample, and this flaw overstates overall performance (Vanguard, 2015).
- Reporting bias: VC firms have a tendency to underreport underperformance (Phalippou & Gottschalg, 2009).

Prior to discussing the VC asset class' performance, it is fundamental to be familiar with the performance metrics used by VCs.

2.6.1 Venture Capital Performance Metrics

There are two categories of VC performance metrics: absolute return measures and relative performance measure (table 2).

Absolute return measures	IRR, CoC Multiple
Relative performance measures	PME

Table 2: ***Commonly used venture capital performance metrics*** *(Source: BVCA, 2015; author's analysis)*

2.6.1.1 Internal Rate of Return

VC fund's standard measure of performance is the internal rate of return (IRR). The IRR is the project's rate of return that makes the net present value of the project equals to zero (Damodaran, 2014). In theory, an acceptable project is a project with an IRR exceeding the project's cost of capital (Gutmann, 2013). The IRR solves the following Discounted Cash Flow (DCF) equation:

$$0 = -CF_0 + \frac{CF_1}{(1+r)} + \ldots + \frac{CF_n}{(1+r)^n}$$

Despite its heavy usage among VCs and other investment professionals, the IRR is not a perfect measure and has some theoretical shortcomings: (i) the IRR is a "*scaled measure*" and leads the "*decision-maker toward smaller projects, which are much more likely to yield high percentage returns*" (Damodaran, 2014, p.337) ; (ii) the IRR assumes that all the intermediate cash flows can be reinvested at the same IRR ; (iii) it is not clear which rate to use when a project has more than one IRRs (Damodaran, 2014).

2.6.1.2 Multiple

The Cash-on-Cash (CoC) multiple equals the cash returned upon exit of an investment divided by the cash injected by the investor. This metric fails to take into account the time value of money (BVCA, 2015).

2.6.1.3 The Public Market Equivalent

The Public Market Equivalent (PME) (Kaplan & Schoar, 2005; Long & Nickels, 1996) compares a given IRR with the performance of the public market (e.g. BEL 20, CAC 40, and S&P 500). The PME is used to provide a “*like-for-like comparison between*” the VC investment and the public market (BVCA, 2015, p.6).

2.6.2 Some Considerations for Investors

2.6.2.1 Gross vs Net Returns

The VC return metrics can be reported as both net and gross return. The difference between gross and net returns is the GPs’ compensation (management fees and carried interests) and so doing, an educated investor should preferably focus on net return.

2.6.2.2 Importance of the Vintage Year

The vintage year is the first year of capital injection into the fund. Different vintage years have different return profiles, this is the reason why a benchmark of funds should preferably be done with funds having similar vintage to provide an apple-to-apple picture of the situation (Fraser-Sampson, 2011; Jarry-Ferron, 2017). Knowing the vintage year has an even greater importance when assessing the performance of a fund not entirely liquidated yet: a VC fund’s performance chart follows a J curve (figure 12), meaning the fund’s performance is overly negative in its early-years before gradually delivering positive returns as the fund matures and the investments are exited (Diller et al., 2009).

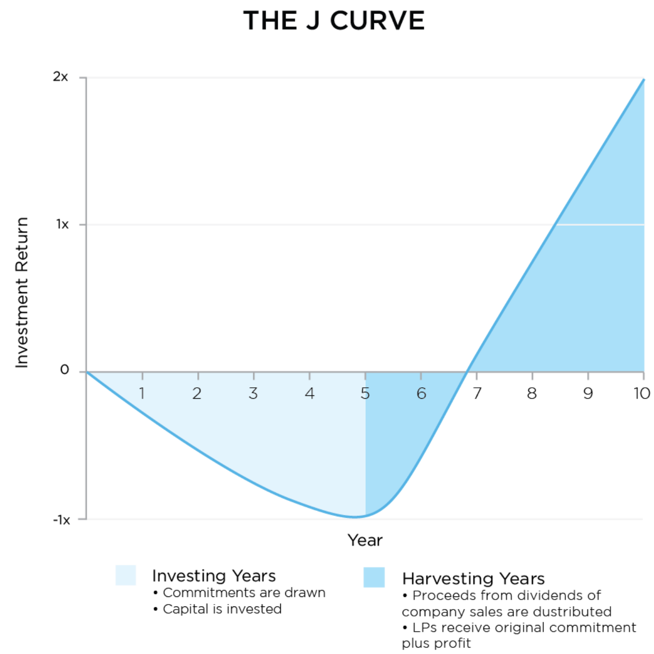

Figure 12: ***The J Curve in Venture Capital & Private Equity*** *(Source: Artivest, 2014. Retrieved from: https://artivest.co/blog/a-private-equity-primer-part-2/)*

2.6.2.3 Should Limited Partners invest in Venture Capital?

There is no clear consensus among academics nor practitioners over overall VC funds' performance (appendix 3). These performance metrics do not make a strong case for venture capital as an asset class, one might accordingly ask 'why do LPs keep on investing in VC funds?' Four main reasons underly this persistence: (i) LPs do not invest in venture capital as an asset class, LPs are keen to invest in top tier funds (e.g. Sequoia Capital, Kleiner Perkins, Accel Partners) able to continuously deliver outstanding returns to investors and/or funds with a distinctive investment strategy (Kaplan & Schoar, 2005) ; (ii) the importance of the vintage year with contrasted returns depending on the fund vintage ; (iii) venture capital investing is for LPs a way to be involved in the booming technology sector and (iv) LPs do not put all their eggs in the venture capital basket, the venture capital asset class usually makes up less than 4% of a given LP's total portfolio allocation (e.g. CalPERS [3] allocates *circa* 2% of its portfolio to venture capital). (Chamboredon, 2018; EVCA; 2004; Mathieson, 2014).

[3] The California Public Employees' Retirement System (CalPERS) is the US' largest public pension fund with $350 billion AUM (Investopedia, 2018)

2.6.3 The Pareto Principle in Venture Capital

Inside a VC fund, there is a portfolio logic, a portfolio is made of all companies invested. For that reason, a VC firm invests in multiple companies and reports performance at the portfolio level (Manigart & Witmeur, 2012). VC is a high risk / high reward game governed by exceptionalism (figure 13): a VC fund's performance and its related portfolio does not have a normal distribution, it follows a power law (figure 14 for an illustrative representation of the power law in venture capital), as a rule of thumbs, a VC portfolio has the following outcome: 50% of companies fail, 30% of companies return capital or marginally exceed the capital invested and 20% of them are homeruns, hence the analogy made with the Pareto principle (Graham, 2017; Sahlman, 2010; Thiel & Masters, 2014: Wilson, 2009).

2.7 Key Learnings

With this section, insights to understand the rules of the VC game have been provided. It became apparent that VCs, with their capital collected from limited partners, are superseding the conservative bank loan industry to be considered as a key source of funding for startups (Manigart & Witmeur, 2012; Tirole et al., 2016). VC investing is a high risk / high reward game and, therefore, aims for investments with outsized returns (Sahlman, 2010; Wilson, 2009). When done well, venture capital is a formidable tool to support entrepreneurship, innovation and economic growth overall (European Commission, 2011; Kortum & Lerner, 2000; Popov & Roosenboom, 2009; Thiel et al., 2011). The subsequent section introduces the various governance mechanisms developed to align the potentially conflicting interests of venture capital investors and startups entrepreneurs, to reduce the asymmetry of information and high-risk inherent to startup investing.

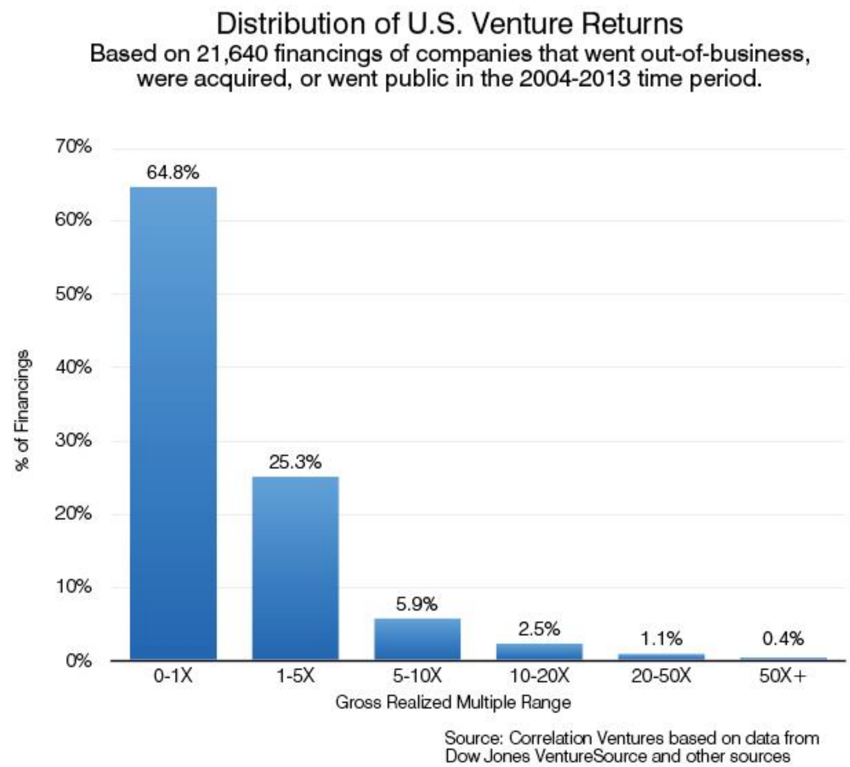

*Figure 13: **Illustration of the 'exceptionalism' in Venture Capital** (Source: Kramer, 2014. Retrieved from: https://www.fenwick.com/publications/pages/silicon-valley-venture-survey-third-quarter-2014.aspx*

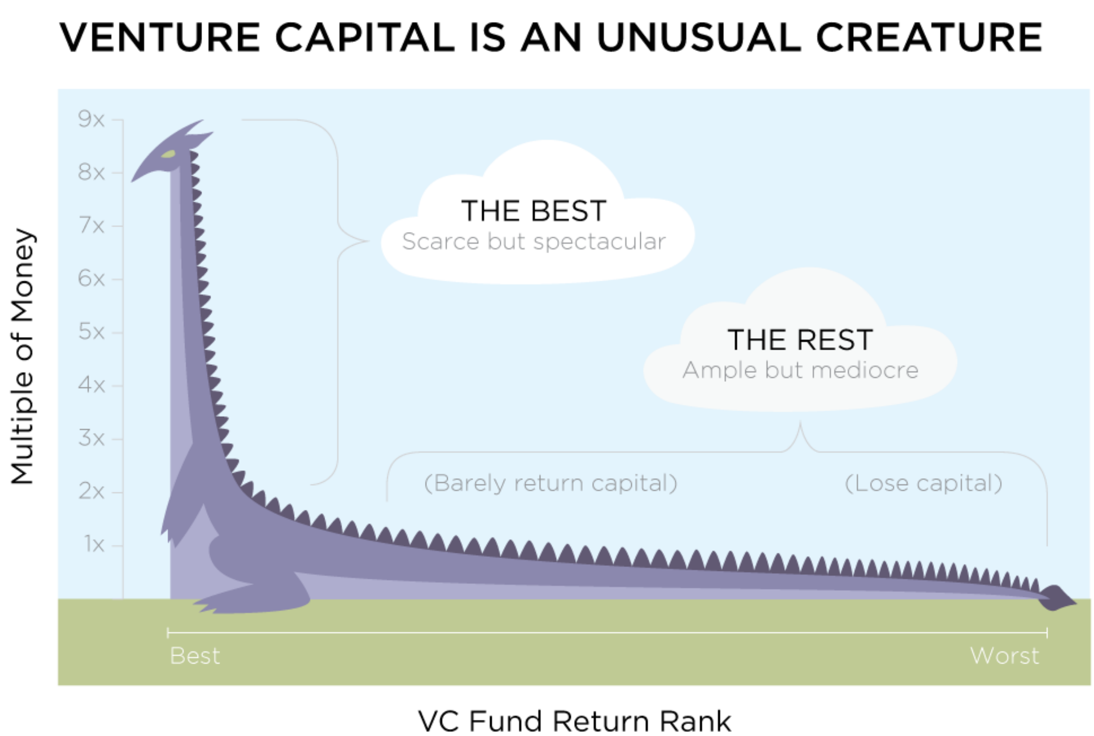

*Figure 14: **Illustration of the power law in Venture Capital – VC return's chart has a dragon-looking shape** (Source: Artivest, 2014. Retrieved from: https://artivest.co/blog/a-venture-capital-primer-part-3/)*

3 Introduction to Corporate Governance

The previous sections introduced the dyad VC-startup (i.e. the entrepreneur); this section draws on the corporate governance literature to present the customary mechanisms put in place to align their interests and govern their relationship.

3.1 Definitions and Key Challenges

Corporate governance has become a popular subject in academic's research (e.g. Cerrada & Janssen, 2006; du Bus de Warnaffe & Van Den Berghe, 2015; Shleifer & Vishny, 1997) and practitioners (e.g. OCDE, 1999; Standard & Poor's, 2004) discussions, hence the many definitions of corporate governance.

The concept of corporate governance traces its origins from the Anglo-Saxon world (Bakkour, 2013) and is defined by the Cadbury Committee as "*the system by which companies are directed and controlled"* (in the Cadbury report, 1992, p.14). The Belgian Code on Corporate Governance for listed companies offers a similar definition putting the emphasis on rules, "*Corporate governance is a set of rules and behaviours which determine how companies are managed and controlled*" (Corporate Governance Committee, 2009, p.7). Additionally, corporate governance also involves the balance of power and relationships between the company's key stakeholders (McManus & White, 2008).

A substantial body of literature stresses the importance of the shareholder's control over the company's management as one of the key elements to understand corporate governance (Charreaux, 1997; Damodaran, 2010; Finet et al., 2005; Shleifer & Vishny, 1997). This reveals that the foundation of corporate governance lies in the potential conflict of interest between the management and the shareholders, this conflict is at the core of the theory of agency (Jensen & Meckling, 1976). In essence, within a firm, agency problems arise when the management run the company in a manner that fails to maximize shareholder value and therefore hinder shareholders' interests. One of the main objectives of corporate governance mechanisms *ergo* consists in providing solutions to the agency problem and reducing the asymmetry of information between the various players of a firm (Cerrada & Janssen, 2006). Sound corporate governance also has other objectives such as growth and performance (Buysse, 2017; EY, 2015; OECD, 2004).

3.2 The Specificity of Small Unlisted Firms

The core of this paper revolves around venture-backed startups and although corporate governance is a popular subject, most of the discussions focus on listed firms (Cerrada & Janssen, 2006). This section looks at specificities of corporate governance that can be found in small unlisted firms. A subsequent section covers the VC's governance considerations when entering into a startup.

3.2.1 Corporate Governance of unlisted firms

The little attention given to unlisted firms inside corporate governance discussions is often explained by the fact that the clear separation of ownership and management of the firm is largely found at listed firms (Cerrada & Janssen, 2006), the agency problem is *ipso facto* a blurrier issue for unlisted firms.

This does not exclude SMEs from applying corporate governance best practices and this is the case for several reasons:

- Agency conflicts arise when a company opens itself to external capital providers to shape its growth. This is the case for startups raising equity from investors to support their growth, different groups of investors enter into the capital, diluting then the owner-manager (Broughman & Fried, 2012).
- The unification of ownership and control can be a source of inefficiency, for example, due to the absence of an external perspective on the firm (Cerrada & Janssen, 2006)
- Corporate governance can be a catalyst for the growth, sustainability, innovation, and professionalization of firms (Buysse, 2017; EY, 2015).

All these points explain why best practices of corporate governance also apply when adapted, to smaller unlisted firms.

3.2.2 The Code Buysse III

In Belgium, the main source of corporate governance recommendations for unlisted firms is the Code Buysse. The general recommendations for SMEs relate to the firm's strategy, relationships with external stakeholders, the BoD, the management, the shareholders and the disclosure of corporate governance rules (Buysse, 2017). The recommendations that are the most relevant for this dissertation are discussed: (i) the BoD, and (ii) the shareholders.

3.2.2.1 The Board of Directors

The BoD is *de jure* the firm's organ with the power to perform all acts necessary for the realization of the firm's corporate purpose. Inside the firm, the directors' fiduciary duty is to ensure that managers serve the firm's interests as elected representatives of the shareholders (Belgian Company Code Art. 518; Damodaran, 2014) and outside the firm, represents the company *vis-à-vis* third parties (Belgian Company Code, Art. 522).

In parallel to the mentioned legal considerations, the Code Buysse (2017) attributes six missions to the BoD: (i) legal duties (e.g. closing the annual accounts) ; (ii) the general administration of the firm (i.e. strategic decisions) ; (iii) effective control of the firm and the management ; (iv) acting as a sounding board for the management ; (v) acting as an employer for key positions within the firm; (vi) acting as the firm's ambassador (the BoD embodies the value of the firm). De Vlaminck & Sarens (2014) group these missions in three categories: (i) service role − the BoD offers advice and evaluates the management's decisions; (ii) monitoring role − the BoD actively mitigates the agency conflicts and ensures the shareholders' interests are protected; (iii) networking role − the BoD provides external resources to the firm.

The Code Buysse (2017) recommends that all the rules about the functioning of the BoD be formalized and laid down within the bylaws of the company.

3.2.2.1.1 Composition

According to the Code Buysse (2017) and various studies (e.g. Godard & Schatt, 2000), an effective BoD is complementary and diverse with both internal and external directors.

3.2.2.1.1 Size

The Belgian Company Code presents a minimum number of 3 directors (Art. 518), however, according to a large number of academics the legal requirements are suboptimal, for that reason, research tried to assess the right BoD size. Large BoDs suffers from coordination problems, weaker effectiveness and management domination (Godard & Schatt, 2005; Jensen, 1993); conversely, a larger BoD can be the synonym of a larger amount of resources at the disposal of the firm (Godard & Schatt, 2005). These contradictory suggestions are also the results of empirical studies (Godard 2002; Pearce & Zahra, 1992; Yermack, 1996), there is, therefore, no "one size fit all" and the Code Buysse (2017) does not pronounce itself on the optimal BoD size.

3.2.2.1.2 The Benefits of an Active Board

In the opinion of du Bus de Warnaffe & Van Den Berghe (2015, p. 47), an active BoD with external directors has an added value for SMEs because: (i) "*it is an essential step towards the professionalization of the company"* ; (ii) "*it stimulates strategic thinking"* ; (iii) "*it is an ideal instrument for monitoring and managing risks"* (iv) "*it promotes long-term leadership and continuity"* ; (v) "*it helps the company to cope with complexity* ; (vi) *it supports the growth and development"* and (vii) "*it works to harmonize orientations and consistency between shareholders"*.

3.2.2.1 The Shareholders

Overleveraged firms set aside, the shareholders are the number one source of financial resources for the firm and in exchange for their contribution, they acquire three types of rights: (i) financial rights; (ii) information rights and (iii) political and administration rights (Albouy, 2002; De Cordt 2007).

First, the financial rights. In exchange for his/her contribution to the funds, the shareholder asks for a remuneration. This results in the payment of dividends. Dividends are cash redistribution of a portion of the company earnings to shareholders; the dividend policy is set by the General Meeting of shareholders following the proposal of the BoD (Belgian Company Code Art. 617-618). Startups are fast-growing companies and are expected to reinvest their earnings into further growth and so doing, to pay fewer dividends (Damodaran, 2014). The dividend is not the only component of the shareholder’s remuneration, the shareholder can be remunerated through capital gains (Albouy, 2002).

Second, the information rights. Independently of the publicly available information, the shareholder can exercise his/her right to information by obtaining corporate documents (e.g. financial statements) concerning the company's operations (Albouy, 2002).

Third, the political and administration rights. Shareholders have the right to call a General Meeting, to ask questions to directors, to vote, to appoint and remove directors (De Cordt, 2007). This the way for shareholders to control the firm’s BoD and management (Ginglinger, 2002).

3.2.2.2.1 Shareholder Activism

The political and administration rights are the foundation of shareholder activism. “*Shareholder activism is about taking action or getting involved by asking questions, demanding accountability and offering suggestions by shareholders to management. It is a way that shareholders can […] influence a corporation’s behaviour*”. (Lekhesa, 2009, p.6). Shareholder activism can have several underlying motives (e.g. corporate social responsibility, changes in corporate strategy, addressing managerial deficiencies), however, the common ground of these motives is the shareholders' willingness to add value to the firm (Petrus, 2016).

Activism can take several forms from quiet discussions with the management to more severe forms such as public dispute with the management, naming and shaming, proxy fights at General Meeting and open letters. The use of these different tactics is called making an activist campaign. Lazard (2018) periodically reviews the activist campaigns at listed firms and in 2017, one-third of all activist campaigns were M&A-related, 32% were about BoD issues and 31% were business strategy-related (appendix 4).

Although corporate governance codes call for active shareholders (e.g. the Code Buysse), there is no consensus among academics about the empirical evidence on shareholder activism's impacts on corporate performance and value creation (De Jong, Mertens, van Oosterhout, Vletter, 2007).

VCs involved in post-investment activities such as recruitment, strategy, governance engineering, operational engineering, helping with fundraising and interacting with portfolio companies' management are considered as active shareholders (Bottazzi, Da Rin & Hellmann, 2007; Jackson et al., 2012; Kaplan & Stromberg, 2008). This high level of involvement compared to other investment professionals is driven by the risks and potential agency problems related to the nature of startups (young, growth-oriented companies with limited tangible assets) (De Clercq & Manigart, 2007). At the same time, this post-investment involved can be used as a marketing and differentiation tool in an increasingly competitive market for the best investment opportunities (Coppey, 2016; Golden, 2017; Maxwell, 2015). VC activism's classifications can be condensed into two categories: (i) value-adding activities and (ii) monitoring activities (Ed-dafali et al., 2016).

3.2.2.2.2 How to Engage with Shareholders

The Code Buysse (2017) prompts the BoD to promote shareholder engagement, in particular by preserving the rights of minority shareholders and ensuring that all shareholders receive equal and periodic information. Outside the articles of association (AoA), shareholders can form a contract regulating the main shareholders' rights and obligations and the way to settle conflicts between them. This contract, called the shareholders' agreement (SHA) is optional, but highly recommended by the Code Buysse (2017). The SHA is mainly done to protect minority shareholders, facilitate the entry and exit of the company's capital (e.g. preemption right, drag along, approval clauses) and to offer provisions concerning the composition of the BoD. As a contract, the SHA is regulated by the Civil Code, not the Company Code.

3.3 Corporate Governance Mechanisms Specifics to Venture-backed Startups

3.3.1 Agency theory and Asymmetry of Information

The agency theory is the prominent theoretical lens used to analyze the VC-startup relationship where the VC is the principal and the entrepreneur is the agent (de Oliveira Tavares Gärtner, 2016; Rosso, 2012; Sapienza & Villanueva, 2007). The agency problem is exacerbated by information asymmetry prior to the VC investment, and potentially misaligned incentives after the VC investment (Grégoire, 2017; Kaplan & Strömberg, 2004). The information asymmetry and misaligned incentives lead *nolens volens* to adverse selection and moral hazard (Grégoire, 2017; Kaplan & Strömberg, 2004). These risks are worsened by the uncertain environment of startups (Lerner et al., 2012). In order to overcome the risks and potential agency problems related to startup investing, VCs are above than average active investors, they are involved in monitoring activities and are known to take an active involvement in the startup after the investment, hence the concept of smart money (De Clercq & Manigart, 2007). The instruments used to minimize the risks can be split into three categories: (i) the financial contracting mechanisms of the VC deal structure; (ii) the economic terms governing the VC-entrepreneur relationship and (iii) the control terms governing the VC-entrepreneur relationship. The two latter categories are often summarized in a term sheet or the SHA.

The first categories are the financial contracting instruments. The commonly used financial contracting mechanisms are (i) the staged investments and (ii) the syndication of investments. These instruments contribute to minimizing various agency and asymmetric information problems (Gompers, 1995; Kaplan & Strömberg, 2004; Lygnou, 2016).

3.3.1.1 Staged Investments

Early-stage startups have limited track-record, therefore, for a given startup, VCs do not release capital all at once, but in stages. The capital is gradually deployed to the startup after the accomplishment of various business plan's milestones leading to successive funding rounds (Dahiya & Ray, 2011; Kaiser et al., 2007). This method reduces the amount of money invested at the earliest stages given the high level of risk associated with these stages and allows the VC to gather first-hand information about the funded venture, thus, reducing information asymmetry (Gompers, 1995).

3.3.1.2 Syndication of Investments

In a syndicated investment, "*two or more VCs come together to take an equity stake in an investment*" (Lockett & Wright, 2001, p.1). The syndication leads to a risk and information sharing platform among the VCs, hence a reduced asymmetric information and risk taken by each VC. The VC initiating and leading the financing arrangement is the lead investor. The lead investor sets the pace at the pre-investment phase (e.g. the price and terms of the investment) and contributes the most to the portfolio company in terms of monitoring and value-add at the post-investment phase (e.g. in the syndicate, the lead investor is usually the one granted with board representation in the funded venture). (MacMillan & al., 1989; Wilson, 2013). Understanding the co-investment relationships within the VC community is essential for entrepreneurs. For example, Accel Partners, a prominent VC firm, often looks at Meritech Capital Partners, New Enterprise Associates, and Sequoia Capital as co-investors (appendix 5; CB Insights, 2016).

3.3.2 Importance of the Term Sheet and the Shareholders' Agreement

The previous sections' examples illustrate the need for contracting in VC financing. The agency problem shapes the contractual provisions used to govern the VC-entrepreneur relationship (Burchardt et al., 2016). The document outlining these provisions is the term sheet. The term sheet is central in the negotiations prior to a VC investment as it outlines the details of the future investor-investee relationship and the investment valuation (Gompers et al., 2016; Valorge, 2014; Wilmerding, 2003). Appendix 6 offers an example of a standard term sheet; this template, drafted by The Galion Project with the help of two law firms, has been endorsed by various prominent VCs (*inter alia*, Accel Partners, Idinvest, Serena Capital, and Partech). The term sheet is not the final legal document governing the VC-startup relationship, the term sheet is a non-binding agreement laying out the terms by which the investor makes his/her investment, which will then be translated in definitive legal documentation, such as the SHA (Cumming & Johan, 2009; Shaw, 2015; VentureChoice, 2008).

The next section provides an overview of the most common terms of a term sheet. Terms can be split into two categories: (i) economic terms − terms impacting the investor's return; (ii) control terms − mechanisms that allow the VC to exercise control over the startup (Feld & Mendelson, 2011).

3.3.2.1 Economic Terms

3.3.2.1.1 Pre- and Post-Money Valuation

The most negotiated term between the entrepreneur and the VC is the price of the investment that will be the investor's equity contribution. "*While price per share is the ultimate measure of what is being paid for the equity being bought, price is often referred to as valuation*" (Feld & Mendelson, 2011, p.77).

Valuation comes in two forms: pre-money and post-money valuation. Pre-money valuation refers to what the investor value the company prior to the cash investment; post-money valuation is the pre-money valuation plus the total new investment. The pre- and post-money valuation distinction can be viewed differently with the share of ownership to trade as main element of negotiation. In this case, the analysis starts with the post-money valuation defined as the VC's capital injection over the percentage of ownership requested in exchange. And the pre-money valuation is the post-money valuation less the VC's capital injection (Damodaran, 2015).

Another factor to take into account is the existence of potentially dilutive instruments in the startup's capital structure, such as stock option pools and warrants. Term sheets frequently refer to fully diluted valuation, including then, in-the-money warrants and in-the-money options. This is on the basis of a fully diluted pre-money valuation that the investor determines of much ownership to ask in exchange of the investment (Feld & Mendelson, 2011; The Galion Project, 2018).

There are several startup valuation methods (e.g. IRR analysis/VC method, DCF, multiples methods). Damodaran (2016) provides a telling methodological overview of the IRR analysis/VC method in figure 15. Gompers et al. (2016) find that VCs primarily rely on multiples methods and IRR analyses/VC methods. That being said, startup valuation is not an exact science and more a pricing game than an intrinsic value game (Damodaran, 2016; Leonetti, 2016).

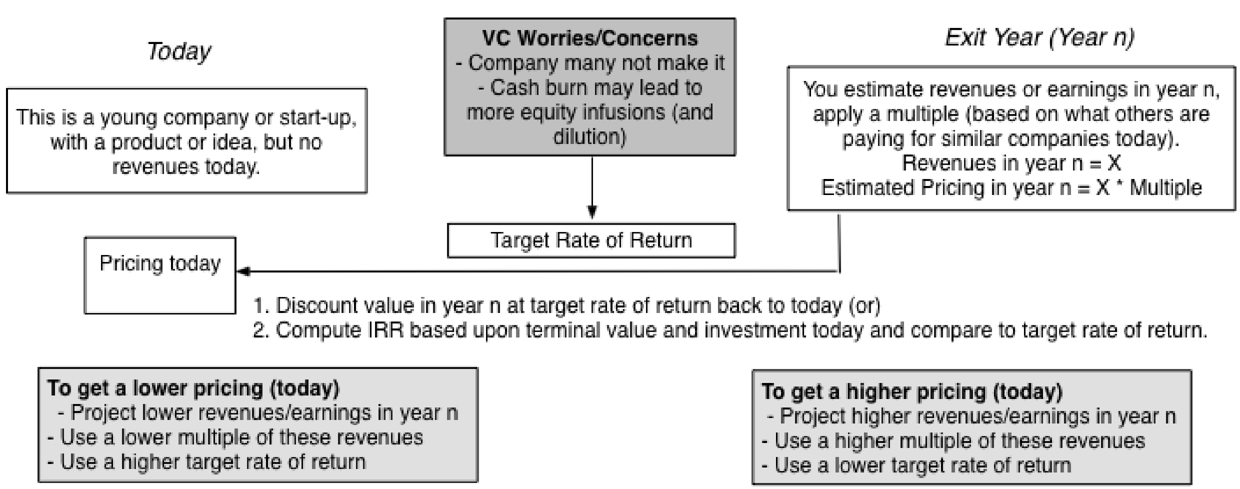

Figure 15: ***The VC method*** *(Source: Damodaran, 2016. Retrieved from: http://aswathdamodaran.blogspot.com/2016/10/venture-capital-it-is-pricing-not-value.html)*

3.2.2.1.2 Liquidation Preference

Given the risk associated with their investments, VCs use downside protection instruments (Damodaran, 2015). The liquidation preference is one of them and refers to how the proceeds is shared in case of a liquidity event (i.e. sale, merger, bankruptcy). "*More specifically, liquidation preference specifies which investors get paid first and how much they get paid. [...] This protects VCs from losing money by making sure they get their initial investments back before other parties."* (Investopedia, 2018, para.1).

There are two types of liquidation preference provisions: (i) straight liquidation preference and (ii) participating preferred. In a straight liquidation preference, the preferred shareholder receives his/her initial investment amount plus declared accrued dividends; in a participating case, the preferred shareholder receives his/her liquidation preference and also participates in the distribution of the remaining shares with the other common shareholders on a predefined conversion ratio (Feld & Mendelson, 2011; Hadzima, 2012). Liquidation preferences can come with a multiple (e.g. 2x, 3x, 4x multiples). In this case, the preferred shareholder is entitled to receive a multiple of his/her initial investment before the rest of the proceeds is shared with common shareholders (Walker, 2010). Appendix 7 provides an overview of the different possible outcomes of a liquidation preference's execution.

An investor with a liquidation preference does not enter in the startup's capital with common stocks: the investment takes the form of preferred stocks or convertible preferred stocks; the use of preferred stocks changes the capital structure of the target company (Hadzima, 2012) (see figure 16 for an illustrative capital structure).

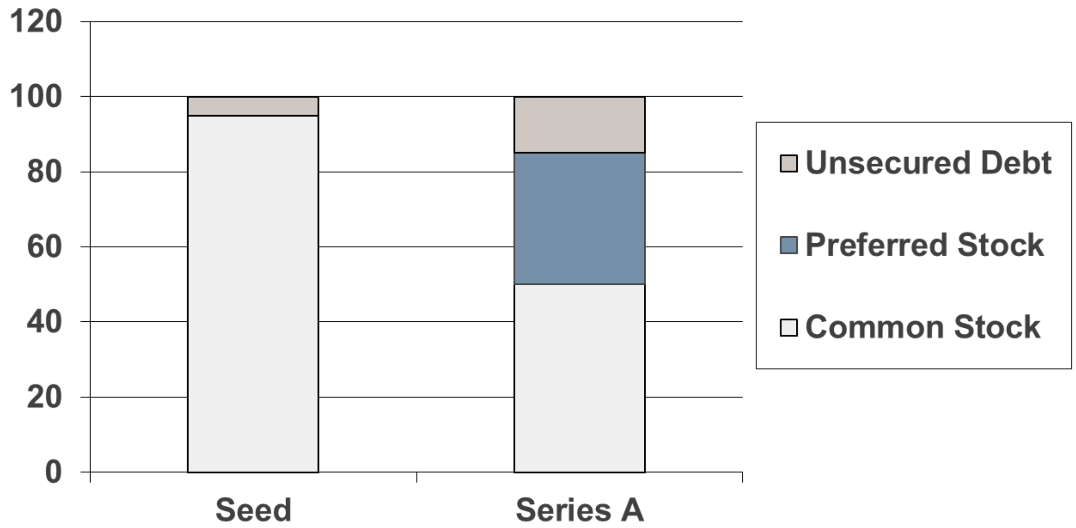

Figure 16: ***Capital structure instruments: percentage of capital structure by stage*** *(Source: Hadzima, 2012, p.16)*

3.2.2.1.3 Leaver and Vesting Clauses

The vesting provision applied to the startup's founder addresses the incentive problem of the agency conflict (Grégoire, 2017; Kaplan & Strömberg, 2004). For instance, a vesting provision ensures the founders remain with the company "*at least until certain milestones are achieved*" (Hanson Bridgett LLP, 2006, p.2). The principle is that the longer a founder remains active, the more he/she is financially compensated for his/her contribution to the firm. This financial compensation is tied with the founders' shares where the founders earn their equity over time. (The Galion Project, 2018). To provide a practical example, in a 36-month vesting plan, the founders unlock 1/36 of their shares every month.

Leaver clauses govern the management (including the founders) departure from the startup with provisions of compulsory transfer of the departing party's shares. Good leaver usually means the departure does not result from misconduct or disagreement (e.g. incapacity). Bad leavers usually result from misconduct (e.g. fraud). Voluntary resignation can be good or bad depending on the situation. A good leaver usually requires a transfer of shares at fair market value. A bad leaver clause usually seeks to penalize the departing party for his/her actions, with a transfer provision at nominal value, which results in a forced sale of the shares at the discount to the fair market value (Wood, 2015).

3.2.2.1.4 Employee Option Pool

A pool of common stocks is held aside for existing and future key employees to attract and retain them. As outlined in the discussion about valuation, such option pool is a potentially dilutive provision and is, therefore, one of the elements coming into play in the valuation negotiation (Gibney, 2013).

3.2.2.1.5 Antidilution Clauses

An antidilution adjustment protect the VCs' ownership against subsequent dilutive funding round at a lower price per share (i.e. a down round) (Destin, 2009). Simply put, an antidilution provision grants the holder of such provision the right to receive further stocks in the event of a down round. The two common types of antidilution provisions are the 'full ratchet' and the 'weighted average' (Grégoire, 2017).

3.2.2.1.6 Pay-to-Play

A pay-to-play provision is used to encourage existing investors to participate in the startup's subsequent funding rounds *ergo* avoiding signalling risks to outside investors. Pay-to-play provisions typically take the form of eliminating the non-participating investor's anti-dilution protection and/or forcing a conversion of preferred stocks into common (Hanson Bridgett LLP, 2006).

3.3.2.2 Control Terms

VCs are often minority investors and are not involved in the daily operations of the startup, hence, the "*relatively limited visibility of their investment*" (Valorge, p.54). Thus, the need for control terms.

3.3.2.2.1 Board of Directors

As outlined in the Code Buysse (2017), the BoD is one of the most important corporate governance mechanism. The BoD is the forum where the most strategic decisions for the firm are made and as Feld & Mendelson (2011, p.115) put it, "*the Board is the startup's inner sanctum, strategic planning department, and judge, jury, and executioner all at once*", VCs therefore frequently request board representation (Hanson Bridgett LLP, 2006).

From the entrepreneur's perspective, a well-functioning and composed BoD is a source of industry expertise, network, resources, and counsel on strategic decisions (Roth, 2012; Young Entrepreneur Council, 2018). From the VC's perspective, the BoD is the organ where investors can fully play their role of activist investors, influence and monitor the management (Cohn, 2016; Guberna, 2015, Sullivan & Kelly, 2008). Literature suggests that venture-backed startups' BoDs are relatively active (Busenitz et al., 1997). According to the analysis performed by De Vlaminck & Sarens (2014), the BoD is considered by investors as the main governance mechanism to influence the startup's strategy and not sitting at the BoD diminishes the VC's influence. As stated by de la Rochebrochard (2016, para.5), "*board meetings are like off-site retreat for teams: you honestly emphasize the past and present, address strategic matters and concerns, envision the future and take decisions, all together.*"

The typical early-stage board has three-five directors, composed of (i) the founders and key company executives, (ii) the investors and (iii) one external director. Besides officially elected directors, VCs often want to include board observers, observers are appointed in a nonvoting capacity, but have the right to offer their opinion on company matters and literature has demonstrated that in practice, votes seldom happen thanks to a decision-making process driven by consensus (De Vlaminck & Sarens, 2014; Feld & Mendelson, 2011; Gibney, 2013).

3.3.2.2.2 Protective Provisions and Veto Rights

In order to offset their position as minority shareholders, VCs require veto and special voting rights to block actions that could be averse to them.

Besides veto and special voting rights, the protective provisions can also take the form of negative covenants (Grégoire, 2017).

The key matters at stake (Valorge, 2014, p.54):

(i) "modification on capital/shares (e.g. any redemptions or repurchase of shares, sale of substantial assets, increase or decrease in the number of shares, any change to the rights, preferences and privileges of any shares, change in the BoD size); (ii) payment of dividends; (iii) significant CapEx, annual budget and business plan; (iv) significant operational decision (hiring a key manager, opening of a new office, etc.)."

3.3.2.2.3 Participation and Pre-Emption Rights

Participation rights (also called Right of First Refusal "ROFR") and pre-emption rights provide existing investor the right to participate in future financing rounds before the offering is made available to new investors (Gibney, 2013). These rights often work on a pro-rata basis enabling the investor's maintaining his/her ownership (Gompers et al., 2016).

3.3.2.2.4 Drag Along Clause

A drag-along clause provides majority shareholders the right to "drag along" minority shareholders to join in a sale of the company. This clause prevents minority shareholders to hamper a sale (Gibney, 2013; The Galion Project, 2018).

3.3.2.2.5 Information & Audit Rights

Imposing reporting obligations is standard (Feld & Mendelson, 2011).

3.3.2.3 Implications of the Term Sheet for the Governance of Venture-Backed Startups

After having skimmed through the most typical clauses of a term sheet, one can notice that investors go to great length to reduce the agency costs and mitigate information asymmetries (e.g. board representation, information rights, vesting). One can furthermore notice the prevalence of downside protection strategies within economic terms (e.g. antidilution clause, liquidation preference). The design of these clauses has four clearly defined outcomes: (i) the reallocation of cash flow rights; (ii) control rights for the investor; (iii) dilution for the entrepreneur; and the setup of a founder's incentive scheme (Kaplan & Lerner, 2010).

When negotiated aggressively by the investor, the downside risk is born by the entrepreneur (Grégoire, 2017); this can contribute to mistrust and discontentment in the VC-entrepreneur relationship to come (Gibney, 2013). Additionally, when the competition intensifies among VCs for the most interesting deals, the reputation matters; imposing complex, unusual and seemingly unnecessary terms to founders can tarnish a VC's reputation (Janz, 2014; Krishnan et al., 2011). Research has demonstrated that stringent governance mechanisms from VCs can contribute to investees less receptive to VCs' opinion and advice (Busenitz et al., 1997). Moreover, Bochner & Simmerman (2016) explain that VCs sitting at a startup's BoD are dual fiduciaries, meaning they have fiduciary duties to the VC fund, as well as to the shareholders of the startup of whose BoD they seat. Much of the time, these dual fiduciaries do not create a conflict of interest as there is an alignment of objectives: the startup's common shareholders and the VC fund are both economically incentivized to help the startup grow. However, liquidity events and downside scenarios with their related terms can put the startup's interest at odds with the VC fund's interests. The use of preferred stocks is an example of a potential breach of fiduciary duty toward common shareholders (Bochner & Simmerman, 2016).

Part Two: On-Field Investigations – Empirical Analysis

4 Research Question

It is well documented that on the contrary to a large part of investors, VCs are active investors involved in monitoring and value-adding activities. Even though these activities are complementary, their underpinnings are fundamentally different.

Monitoring activities aim to correct the information asymmetry problems helping the VC tracking its investment performance, and the value adding activities aim to increase the upside potential of the investment (De Clercq & Manigart, 2007). However, monitoring activities are a costly and time-consuming process with an ambiguous opportunity cost (Barney et al., 1989; Sapienza et al., 1996). Regarding the value-adding activities, De Clercq & Manigart (2007, pp.13-14) confirm that the literature's dominant assumption is that "*VCs do add value*" beyond financial capital with three major roles played: (i) a sounding board for strategic matters; (ii) an operational role as providers of resources and (iii) a personal role of mentors. That being said, it is not all rosy. Sahlman (1990) paraphrased by De Clercq & Manigart (2007, p.12), explains that "*a VC is often responsible for almost nine investments and sits on five BoD."* Hence, the inability to allocate the right time to each portfolio companies leading to suboptimal value-adding activities (Berg-Utby et al., 2007). Furthermore, past research on venture capital value-add might be distorted by the survivorship and reporting biases with samples putting a greater emphasis on success stories (Busenitz et al., 2004; De Clercq & Manigart, 2007; Manigart et al., 2002).

From the entrepreneur's perspective, monitoring activities contribute to the sets up of mature corporate governance practices and improved internal and external reporting (De Clercq & Manigart, 2007). Value-adding activities contribute to the professionalization of the startups (Hellman & Puri, 2002) with investors playing the role of true mentors and enablers for entrepreneurs. However, monitoring activities have the same drawbacks for entrepreneurs as for investors (i.e. time-consuming even for *bona fide* entrepreneurs).

One complementary drawback is the creation of a feeling of mistrust which might hamper the investor's value-add capabilities (Busenitz et al., 1997). Busenitz, Moesel & Fiet (2004) built upon that and found out that entrepreneurs treated in a procedurally unfair manner by investors underperform, while the VCs' value adding activities do not substantially improve a venture's chances of success. Moreover, the VC's motives behind his/her activism might be misaligned from the entrepreneur's interest: a VC fund has a finite lifespan with economics creating the need to invest in homeruns, hence the temptation to push the startup toward a premature and inflated exit (e.g. In 2006, Accel Partners, Facebook's lead investor, urged Mark Zuckerberg to accept a $1 billion buyout from Yahoo! Offer refused and in July-18, Facebook has a market capitalization of *circa* $520 billion; Friend, 2015) which requires substantially more funding and, thus, more diluted founders and early investors (Busenitz et al., 1997; De Clercq & Manigart, 2007; Lennon, 2013; Turcan, 2008).

In sum, although the literature suggests that VCs are active investors, there is no consensus around the empirical evidence of whether the VCs' implication adds *sensu stricto* value for both the entrepreneur and the investor. The literature remains vague on what is the right degree of investor's involvement and fails to offer entrepreneurs the insights on where the opportunity cost of being monitored becomes too high and if these activities are a necessary evil. One might, therefore, suggest that startups might be better off with hands-off investors. This is the reason why this paper's research question is the following: *"Venture capital activism: how to foster sound investor-entrepreneur post-investment relationships?"*

5 Research Design

The aim is to address the broad spectrum of investors' stances between passivity and activism. It will, therefore, be possible to compare hands-on and hands-off investors and evaluate which attitude potentially creates the better functioning VC-entrepreneur relationship. As a result, this paper intends to provide entrepreneurs and investors with practical recommendations set into an actionable framework on how to nurture rewarding collaborations.

5.1 Methodology and Data

5.5.1 The Case for Using Qualitative Research Methods

Previous research on shareholder activism have often adopted a quantitative approach making for example regression analyses with earnings per share as dependent variables (e.g. Bauchau, 2016; Huang & Xie, 2016). In this thesis' case, rigorously doing such analysis could not be smoothly feasible given the fact that this paper discusses venture-backed startups, hence private companies with a scarce supply of publicly available data and VC remains an opaque industry with players reluctant to provide granular data at the portfolio company level. Furthermore, qualitative methods have several strengths such as a greater proximity to the situation studied, an assessment of the 'hows and whys', the tracking of unexpected events, the collection of the interpretations of events by different players and the possibility to give a voice to players whose views are rarely taken into account (Lejeune, 2013; Sofaer, 1999). Moreover, part of the aim is to study the investor's behaviour and this study relies on De Vlaminck & Sarens (2014) approach which used a qualitative method: collecting VCs' opinions allowed them to dig into VCs' behaviour.

De Vlaminck & Sarens (2014) suggested in 2014 that researchers should conduct interviews with both VCs and entrepreneurs to gain a better understanding of the VCs' influence on portfolio companies. For that reason, semi-structured interviews with both parties have been conducted as they might have a different perception of VC activism. Semi-structured interviews have the advantage of allowing the researcher to gather rich insights on a complex topic while framing the conversation with an interview guide (Bryman, 2003; Lejeune, 2013; Newton, 2010).

5.5.2 Procedure

5.5.2.1 The Venture Capitalists

The VC sample is composed of twelve European investors with typologies aiming to represent a broad spectrum of the industry: (i) independent Belgian VCs; (ii) independent French VCs; (iii) foreign VCs who invest across Europe; (iv) VC funds created and funded by experienced entrepreneurs; (v) CVCs; (vi) government/university-led VCs; (vii) PE funds with a VC department; (viii) an industry representative and (ix) a VC fund specialized in biotechnology. The interviewed investors are presented in appendix 8.

Interviews are based on an interview guide (appendix 10) consisting of fourteen questions. The interviewees had access to the guide prior to the interviews. Interviews lasted between twenty-five and forty-five minutes depending on the demeanour of the interviewee. All conversations have been recorded and written down. The interviews had four sections. The consultations started out with introductory questions to break the ice and to allow the interviewee to present himself/herself, its company and strategy. Then, questions about the VC's investment model with a focus on the decisive factors of an investment and the term sheet negotiation have been asked. Third, the discussions moved on to the post-investment relationship with questions about the investor's role in the portfolio company, the nature of the value-adding activities, the opinion on shareholder activism, the motives and the opinion on how to handle disagreements between the investor and the management. The interviews reached an end by giving interviewees the opportunity to bring up topics deemed important by him/her which had not been discussed yet.

5.5.2.2 The Entrepreneurs

The sample is composed nine French and Belgian startups with a diverse typology in terms of shareholding: (i) startups backed by BAs; (ii) startups backed by international VCs; (iii) startup backed by government-run VCs; (iv) startups backed by independent VCs; (v) bootstrapped startups and (vi) one intermediary between entrepreneurs and investors whose objective is the promotion of the growth of entrepreneurial firms. The entrepreneurs' sample is smaller than the investors' sample because the point of theoretical saturation where further interviews do not deliver new information was reached faster (Bloor & Wood, 2006; Thiétart, 2003). Interviews are based on an interview guide (appendix 11) consisting of sixteen questions. The rest of the procedure for entrepreneurs was, *mutatis mutandis*, akin to the procedure for investors. The interviewed entrepreneurs are presented in appendix 9.

5.5.2.3 Additional Considerations

The first part of the data analysis started with the transcript of the interviews. Then, the coding method vulgarized by Lejeune (2013) was applied. Following the feedback of some interviewees concerned about the potentially sensitive information the consultation would gather, it has been decided to not disclose the full interview transcripts to safeguard sensitive information. Furthermore, ensuring this level of confidentiality reassured the interviewees and enabled them to share polarizing thoughts and to speak freely about the ecosystem without fear of consequences nor backlash. Having said that, anonymized quotes from the interviews are used to illustrate the findings. Most of the interviewees were genuinely interested in the thesis' topic and some of them requested a copy of the paper. "*It is an interesting, but rather new topic in Europe; we therefore lack perspective and, thus, you are in a good position because the ecosystem has not yet seriously thought about it and you will be able to propose the first lines of inquiry and thought".* [An interviewed VC].

6 Findings

6.1 The VC's perspective

The interviews' results are presented as follows: pre-investment considerations having repercussions on the investor-investee relationship, the term sheet & the shareholder agreement, VC activism, the channels employed to exert influence, the funds' characteristics having repercussion on the investor-investee relationship and considerations at the VC market level. The last part of this section is the key takeaways from the investors' interviews and aims to highlight the key findings and paint an accurate picture of the VC's perspective on the investor-investee relationships. These key takeaways are data points used to feed the proposal of framework to better configure the investor-investee relationship.

The different interviewees are labelled as Case 1,2,3,4,5,6,7,8,9,10,11 and 12 – in no particular order.

6.1.1 Pre-investment Considerations having Repercussions on the Investor-Investee Relationship

Questions about the most important factors used when deciding whether to invest in a proposal have been asked. The 'team' made the consensus among the interviewees as the number one criterion. This result is consistent with Gompers et al. (2016) findings. Case 3 gave an explanation of the rationale behind this:

"*For us the team is the most important criterion because when the project is young, it is the team that will determine if we will end up with something or not. If the team is not validated, we cannot go further.*" Case 7 gave a more caustic answer on why the team is important: "*The first criterion are men, people. I think men are the level of trouble we accept, there are the most complicated variable, whereas criteria like the market or traction are easier to assess.*"

The market criterion came after the team. *"We look at the growth, TAM and trends on the market"* [Case 1]. The other identified criteria are available in (appendix 12). With these results, the literature cannot be gainsaid (e.g. Coppey, 2018; Fried & Hisrich, 1994; Gompers et al., 2016; Hudson & Evans, 2005; Šimić, 2015; Tyebjee & Bruno, 1984).

There is no clear consensus on whether this feature points toward more passive or more active investors. For a subset of interviewed VCs, choosing the right team is the reason for being hands-off investors.

"At the early-stage, we bet on teams and this is what makes us hands-off investors: a good team has gained our trust, hence, the reduced need to actively influence the management and imposing strict reporting obligations." [Case 4].

This particular VC, is not the only one sharing this exact view, a VC for a rival firm considers that:

“We do not buy a product nor an idea, we invest in a team with whom we are aligned on the vision, our day-to-day influence is therefore not necessary. That being said, we always negotiate a term sheets with clauses aiming to protect us from mismanagement.” [Case 8]

This view is not shared with everyone.

“People is the number one criteria because we have a culture of active partnership. For that reason, we must establish a relationship of trust. We want to be influential and this influence is based on our credibility, hence the importance of trust with the team.” [Case 6]

Case 2 agrees with this view: *“at the seed stage, the human element matters because at this stage of development, all the risk lies in the team. Our role as investors, in addition to being capital providers, is being a coach for the management in order to guide them to the right direction”.* One last investor gave an interesting metaphor: *“Investing in a company is exactly like getting married, it is a long-term commitment, and you must trust and have a fit with the team. If there is no fit with the team, no matter how big the market is, I will not pursue the investment.”*

One pattern emerges (70% of all interviews): the importance of trust, personal fit and relationship building. This pattern is consistent with De Vlaminck & Sarens (2014) findings. Case 12 puts some words on this point:

“It is important to understand that the VC-entrepreneur relationship is not a transactional relationship, but a relationship that is built over time. The human aspect is an important investment criterion, but it will also have tangible implications for the post-investment relationship. I have only been in the VC business for a couple of years, so I lack perspective, but I know that a relationship of trust enables the entrepreneur to see me as an attentive ear with and share his challenges and sensitive information; in other words, an entrepreneur who trusts me will be more transparent and I am sure that this will have an impact on the performance of our collaboration.”

Case 8 adds his take on trust:

“A feeling of mutual trust must be established prior to the investment because we know that if there is no trust in the relationship, the entrepreneur will never be receptive to our opinions and advice.”

This view confirms Busenitz et al. (1997), Sheperd & Zachariakis (2001) and Sapienza (1992) findings, the greater the feeling of trust, and the more open the communication, the more value-enhancing the investor-investee relationship is expected to be.

6.1.2 Term Sheet & Shareholder's Agreement Considerations

Except for 2 VCs, 100% of the interviewed firms agree to say that they are reasonably flexible on the shape of the legal provisions ruling the future investor-investee relationship. Case 8 offers a contrasted answer:

"At the seed stage, we must use standards clauses, this is only after the Series A stage that we can be more flexible, this due to the fact that the target company will have a track-record and reliable performance metrics."

That being said, 92% of the VCs interviewed, negotiate a board seat, whether it is as a director or as an observer. For Case 2, *"in a syndicate deal, the lead investor should always get the board seat*". This opinion is consistent with Kenney (2000) and Wilson (2013). The BoD is considered as the main formal governance mechanism and enables VCs to monitor portfolio companies (*"We always request a board seat to receive the information about the firm at the source."* [Case 10]), facilitate strategic debates, ask the right questions and challenge the management. The various roles attributed to the BoD are consistent with the literature (e.g. Buysse, 2017; De Vlaminck & Sarens, 2014; Feld & Mendelson, 2011; Guberna, 2015, Lerner, 1995). For the only VC not keen on requesting a board seat, *"structuring a board when we invest at the seed stage is nonsensical, it is too early"*. [Case 4]

The board representation aside, there is no consensus among VCs about what could be the standard terms for them. This is due to the fact that:

*"You cannot always compare one deal to another, different variables come into play: the relationship dynamics, the level of competition for the deal and the reputation of the fund involved. If you have a good relationship with the founder and still have to build your reputation as a VC, you will be more likely to come to the table with more 'entrepreneur-friendly' terms, whereas, If you're called 'Accel Partners', you will be more likely to impose standard clauses to the entrepreneur. Let's face it: for the entrepreneur there can be a dilemma between partnering with a highly-reputed fund on poor terms and partnering with a less-known fund, but on better term*s." [Case 8]

Besides, the board representation, the most cited terms were the information rights (reporting obligations), leaver clauses and liquidation preferences (see appendix 13 for the full list). Contrary to what could be expected the ‘valuation’ does not come at the apex of this ranking. The valuation discussion is not the most sensitive topic in the sample:

“For us, the valuation is just the starting point of the negotiation, if the entrepreneur wants a high valuation, that’s fine, but we will compensate by being more stringent on the other terms, especially the liquidation preference and the antidilution clauses.” [Case 1].

For a Case 8, *“young entrepreneurs focus too much on the valuation; but they should look at the whole package.”*

In line with the literature, the VCs’ rationale behind these clauses is to foster interest alignment, reduce information asymmetry and provide downside protection to the fund. The design of these clauses is in line with Kaplan & Lerner (2010).

6.1.3 Venture Capital Activism

A key question is to gather the VCs’ opinions on shareholder activism. 100% of the VCs interviewed consider themselves as active investors. However, depending on the degree of activism, three categories of investors have been identified in the sample: (i) the interventionists (i.e. the proactive), (ii) the available (the reactive) and the facilitators (a degree of involvement between the two first styles). Although the classifications are different, the reasoning is similar to what Perry (1988) has developed when he drew three categories of VCs, from passive VCs only providing money to the active VCs offering unlimited support to portfolio companies. Table 3 provides an overview of the empirically encountered activist styles. These categories are in line with the investigation performed by MacMillian et al. (1989) were three distinct levels of venture capital activism have been identified: (i) *laissez-faire* involvement (i.e. hands-off), (ii) moderate involvement, and (iii) close tracker involvement.

	Interventionist	Facilitator	Available
Locus of control	VC	Shared	Entrepreneur
Nature of relationship	Control sharing relationship	Collaborative relationship	Helping relationship
Contributions of VCs	Encroachment and active involvement in business strategy	Unlimited support from strategy to execution	Advice at key points in time

Table 3: ***Empirically encountered activist styles*** *(Source: author's construction; inspired by Perry, L. T., 1988, p.211)*

The interventionists actively seek to influence and control the management, whether this implication is asked by the management or not.

"Entrepreneurs seem to forget that when they raise external capital, they de facto lose a bit of control and have to share a bit of power. For us this is basic corporate governance and in this frame, we are not afraid to enter in conflict with the management." [Case 7].

For Case 6, *"being truly active is our trademark, our LPs are experienced entrepreneurs and they have provided us with capital to actively share this entrepreneurial ethos with Belgian SMEs, this is our mandate, we do walk the talk and we are not afraid of confronting the management and to veto certain decisions for the good of the company."*

The interventionist style is a minority in the sample, on the other side of the spectrum, there are **the 'available'**. These investors are the most hands-off in the sample and could have been labelled as passive investors, however, they actively monitor their investments, have the resources for value-add activities and the capability of influencing the firm's strategy, and only step-in in two situations: when it is asked by the management (i.e. need-driven) and at specific moments (e.g. when things go wrong, fundraising, exit). This is the approach adopted by Case 8:

"*We are not particularly active because we invest at the Series B round and at this stage, the startup already has a professional structure, however, we do interfere when the firm must take important decisions. And of course, if a founder needs a specific intro to someone from our network, we will do the intro. For the rest, we focus on monitoring our investments."*

Case 1 put it in even simpler terms: *"Depending on the needs, the startups can request our help, but if everything goes well, we limit ourselves in joining the board meetings."* The available approach is coherent with De Vlaminck & Sarens (2014) observation which reveals that investor's implication changes through times.

The third group, **the facilitators** are more nuanced in their approach with a moderate degree of involvement between the potentially disruptive and confrontational approach of the interventionists and the near-passive approach of the available. Three distinctive approaches can be distinguished to characterize a facilitator: the VC as a platform, the Socratic VC and the right-hand man of the CEO.

<u>The VC as a platform:</u> the facilitator is a nexus of various resources going beyond the GP's own time (e.g. access to operational expertise, foster collaborations between portfolio companies and access to a privileged network of HR and commercial opportunities) and actively makes sure the entrepreneur leverages these resources. This 'platform' approach is in line with an accelerating trend described by Bpifrance (2018) and Coppey (2016) in his thesis. This is the approach adopted by an international VC in the sample:

"*What makes our fund different is the fact that alongside the investment team, we have an operational team dedicated to operationally support our portfolio companies, you could consider them as in-house functional experts that directly provide expertise to our startups in key topics like marketing, talent management, product development, business development, etc. Their work begins right after the investment and they are incentivized to actively provide value to the companies because in addition to getting their base salary paid by our firm, they have carried interests."* [Case 5]

Case 5's model might be a solution to the trade-off identified by Jackson et al. (2012): while intense venture capital activism at the operational level is expected to increase VCs' investment returns, this level of involvement is intensely time-consuming and costly for GPs. According to Bpifrance (2018), involving 'operating partners' can be a compelling marketing element strengthening the attractiveness of the VC to LPs and target companies, and has the potential of creating value at each stage of the investment cycle.

<u>The Socratic VC:</u> contrary to the confrontational interventionists in the sample, the facilitators use an indirect approach when it comes to strategic debates, they ask the *a priori* right questions, uncover flaws in strategic reasoning and play the devil's advocate.

By applying this approach, the VC does not dictate the entrepreneur the strategic decisions to make, but rather guide the entrepreneur in the right direction by using the power of dialogue. This approach is favoured by one VC in the sample:

“My first job is to ask the entrepreneur the right questions in order to help him realistically consider all the elements and potential contradictions of his reasoning. This is the reason why I consider that I am applying the Socratic Method, I do not pretend I know more than the entrepreneur, all I am doing is actively asking questions to provoke strategic debates and critical thinking.” [Case 12]

For Case 3, this function is fundamental for investors: *“My number one role as a VC is to gently challenge the management and to be a sparring partner for the founder.”*

<u>The right-hand man of the CEO:</u> Various VCs in the sample shared that startup’s founders, especially the CEOs are lonely persons. This observation is in line with Saporito (2012). In this frame, the facilitator is a trusted advisor for the CEO and it can be noted that being a trusted person builds trust, eases the transparency, and therefore, reduces the need of formal reporting due to more open communication. Sapienza (1992) and Fried & Hisrich (1995) confirm the benefits of this practice.

Whether the investor is an interventionist, an available or a facilitator, the aim is to create value and therefore preparing a company that will have a better value at the time of the exit.

6.1.4 The Channels Employed to Exert Influence

While the BoD is widely considered as the primary governance device, 60% of the interviewed VCs actively used other channels to add value and influence the management.

“The BoD is a formal mechanism, but just the tip of the iceberg. We have board meetings every two months, but most of my contribution is done outside this forum. I use informal channels like SMS or WhatsApp to show the entrepreneur that I am available and can be considered as a trusted person. […] I prefer weekly interactions.” [Case 5].

For Case 7, the BoD and the informal channels are equally important:

“We promote dynamic and lean board meetings where we can get access to strict reporting, review the advancement on the business plan and participate in strategic debates. But, the BoD is just the beginning, between the board meetings, we like to organize thematic workshops and brainstorming sessions.” Case 3 agrees with the fact

that the BoD is just the tip of the iceberg, but he stresses the fact that *"when an investor leaves the BoD, he becomes more passive and less influential."*

These results are in line with De Vlaminck & Sarens (2014), Gorman & Sahlman, (1989) and Sullivan & Kelly (2008) findings.

6.1.5 The Funds' Characteristics

The fund's characteristics findings are on two levels: (i) the typology of the LPs and (ii) the profile of the GPs.

Four main groups of LPs have been identified in the sample: the experienced entrepreneurs, the corporates, the governmental agencies and the balanced LPs. In the sample, the first two groups have a material impact on the value-add the funds provide to portfolio companies.

The funds almost exclusively financed by experienced entrepreneurs tend to be of a smaller size (€34m AUM on average in the sample), but compensate this smaller size by an above average involvement in portfolio companies (given their entrepreneurial experience, LPs directly contribute as advisors) and expected higher credibility:

"Being created and financed by entrepreneurs enables us to leverage a network of resources, expertise and talents to directly help investees, and this features enables us to gain credibility from founders." [Case 6]

The fund's controlled by corporations let portfolio companies leverage their network in a tangible manner. This observation is in line with the observation made by Maula et al., (2005), the involvement of corporate provide an additional added-value.

6.1.6 Market Dynamics

Two VCs shared their views about the potential effects venture capital activism could have on the VC market. For an international VC, this topic will be more and more important in Europe:

"Historically speaking, this topic has been covered in the US, but not in Europe. And although the European ecosystem slowly recognizes that this is an important topic, we

still lack perspective on what are the best practices. I believe that VCs should go further than simply monitoring the investments and chatting about strategy at the BoD and this is the positioning we have chosen at our fund: being a source of operational expertise for portfolio companies. We are still a new fund, so I do not know if it will pay off; but it can be for us a way to build our reputation, differentiate ourselves and shape our branding as a 'VC with true value-add'. That being said, our model is not perfect: we will mechanically be more involved with younger companies or the ones that are struggling, while the companies that are growing well require less help, and so doing, we dedicate less time to the companies that will potentially have the larger impact on our fund. Is it rational to operate that way? I do not know, investing so much time for less impactful startups may not make sense at the very short term, but taking a long term perspective, having been there even for smaller startups could be good for our reputation. Time will tell." [Case 5]

The second venture capitalist has a similar opinion, according to him, emerging VCs will build their reputation on their added-value, their capacity to build trust with founders and the 'friendliness' of their term sheets. From these two opinions, the implied role reputation will take in shaping the investor-investee relationship can be derived.

6.1.7 Key takeaways

The key takeaways should be understood on three levels. On the first level, the VC's practices are in line with the traditional agency theory framework with the alignment of interests, asymmetry of information reduction and downside protection as first motives. The mechanisms on this level are the traditional economic and control clauses that could be found in a term sheet (with board representation, information right, leaver & vesting clauses, and liquidation preference as main clauses) and the active monitoring of the investment aiming to follow up on the gradual progression on the company's business plan (Kaplan & Strömberg, 2004)

On the second level, echoing the 'VC value-add' framework, VCs are involved in various value-adding activities (e.g. strategy definition at the BoD level, access to a privileged network, industry & operational expertise, coach for the management) and as expected by Busenitz et al. (1997) and Sapienza (1992), a favourable context and a trust-based relationship positively impact the VC's involvement and the relationship with the portfolio company's management.

On a third level, venture capital activism can be considered on a strategic and marketing standpoint from the VC firm perspective. Flexibility on the term sheets and a sophisticated approach of venture capital activism (i.e. the facilitator), are *a priori* considered as a reputation-enhancing tool for emerging VCs willing to differentiate themselves in a VC market that is more and more competitive. This third level is in line with Bpifrance (2018) and Coppey (2016) who identified a new generation of VCs differentiating themselves by supporting portfolio companies' daily operations and adopting entrepreneur-friendly practices to improve their value proposition which enhance a given VC's competitive advantage. Figure 17 summarizes how Coppey (2016) understands the benefits of this practice for venture capitalists.

An overview of the key takeaways related to the drivers and impacts of VC activism in the frame of the investor-entrepreneur relationship is available in figure 18.

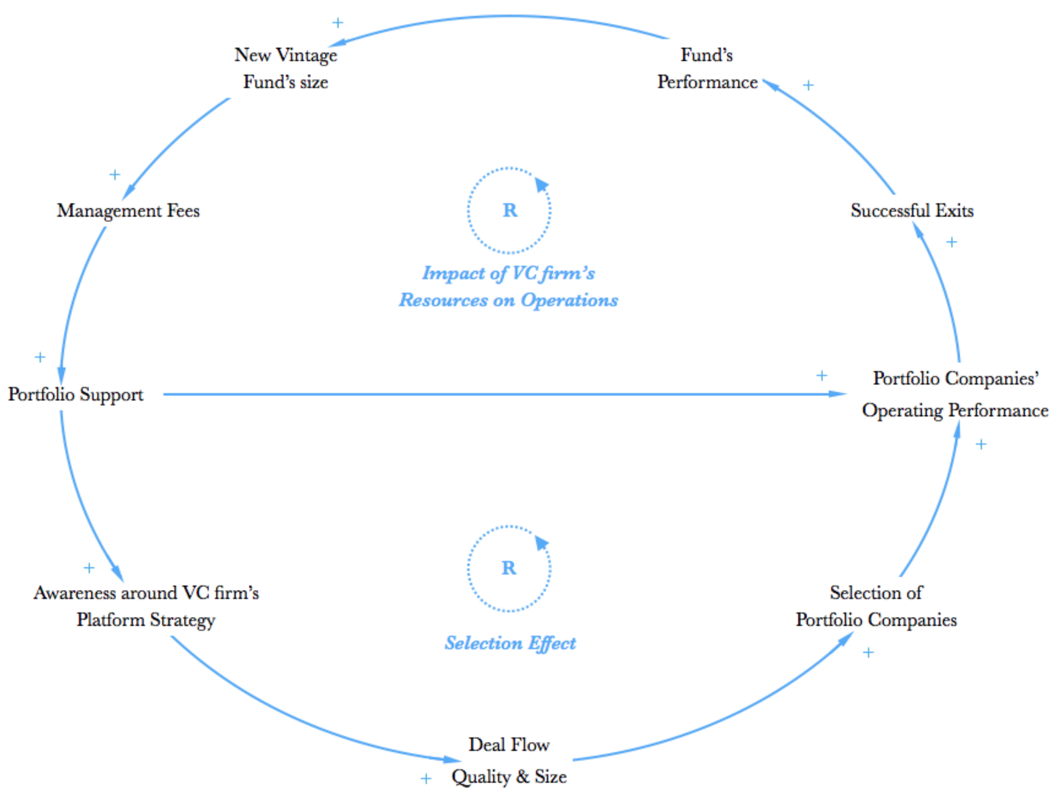

Figure 17: ***The positive feedback loops of VC firm's portfolio support strategies*** *(Source: Coppey, p.20)*

6.2 The Entrepreneur's perspective

The results are presented as follows: the motivation to look for external equity financing, pre-investment considerations having repercussions on the investor-investee relationship, the term sheet & the shareholder agreement, venture capital activism & channels employed to manage investor relations. The last part of this section is the key takeaways from the entrepreneurs' interviews.

The different interviewees are labelled as case 1,2,3,4,5,6,7,8 and 9 – in no particular order.

6.2.1 Motivation to look for External Equity Financing

In line with the very first section of this paper, startups are designed to grow fast and scale and 75% of interviewed entrepreneurs have looked for VC funding to accelerate growth. The growth and scaling efforts create upfront costs. For 40% of the interviewees, these costs are product development-related. For the other 60% of entrepreneurs, the money raised is used to propel the sales & marketing engine. Case 1 also looked for VC funding to fuel growth, but for an even more strategic rationale:

"We need velocity. We see a high level of M&A activity in our sector and if we want to be considered as a target, we need to be attractive, hence, the need of becoming big. We must generate strong MRR figures, we must be present in various locations throughout Europe and we must acquire smaller players; all of this to quickly becoming the number player in continental Europe. We will then be in the right position to be acquired at an interesting valuation. And such growth requires cash."

25% of the entrepreneurs in the sample were not concerned about growth. For them, attracting VCs is the occasion to professionalize the startup, to implement good corporate governance practices (i.e. structuring a BoD) and to partner with seasoned individuals. This rationale is in line with the empirical evidence provided by Hellman & Puri (2002).

6.2.2 Pre-investment Considerations having Repercussions on the Investor-Investee Relationship

Six major considerations have been identified among entrepreneurs: (i) trust & integrity, (ii) actionable network, (iii) relevant know-how, (iv) proven reputation, (v) an entrepreneur-friendly term sheet, (vi) international scope of operations, (vii) substantial AUM. In that particular order.

Trust & integrity: Echoing the importance of the human aspect also found in the investor perspective section, entrepreneurs want to partner with investors they can trust, investors they have built a relationship with, investors who share their vision. This factor is coherent with Sheperd & Zacharakis (2001) that highlighted the importance of trust in the VC-entrepreneur relationship.

Actionable network: Entrepreneurs also look at the investor's network. Depending on their needs, they look at the network for business development purposes, recruitment purposes, exit purposes (i.e. potential acquirers), etc.

Relevant know-how: Having a relevant expertise, whether it is sectoral or general if the investor is a successful entrepreneur who already went to the entrepreneurial route, is highly valued by entrepreneurs. *"If an investor brings a network and expertise with him, I am ready to be a little bit diluted."* [Case 3]

Proven reputation: The overall reputation is a robust factor. The reputation aspect encompasses the quality of the current portfolio and the meaningfulness of the VC's past exits (i.e. substantial trade sales and IPOs).

An entrepreneur-friendly term sheet: Some entrepreneurs are concerned about the terms and conditions to be negotiated with the investor.

"We are not interested in investors throwing spanners in the works, we therefore carefully look at the various terms and conditions. For that, we have worked with a financial advisory firm specialized in capital raising. These guys and our lawyer knew how the VCs work and made sure we signed a friendly term sheet." [Case 5].

This comment echoes Lehtonen & Lahti (2009) and Lahti (2014) research about the several benefits of external financial advisors. Following Lahti (2014), these advisors have a clear added-value for entrepreneurs and are substantial when the entrepreneur is unexperienced in dealing with VCs. Four main reasons: (i) reduction of the asymmetric information problems, (ii) improvement of the terms and valuation for the entrepreneur, (iii) reduction of the likelihood of confrontational negotiations between the entrepreneur and the VC as the advisor put on the role of the 'bad cop' reducing the likelihood of a poor post-investment investor-investee relationship, (iv) acceleration of the fundraising process. Appendices 15 & 16 provide an overview of the main financial advisors involved in the French ecosystem.

For Case 2, the quality of the term sheet is the reason why he quickly thought about raising venture capital abroad: *"We looked for foreign VCs because I feel there is way more competition abroad in the VC space, which means generally better deals for entrepreneurs, in terms of valuation and terms you get on the term sheet."*

International scope of operations: A VC with multiple offices abroad is expected to ease the internationalization process of the new venture.

Substantial AUM: For one entrepreneur, having on board a VC with substantial AUM and dry powder is reassuring, it demonstrates that the VC has the means to participate in the next funding rounds of the startup.

Case 2 has a holistic approach taking into account all the aforementioned criteria, for him, the fundraising process is like a recruiting process:

"For me, this is like recruiting a senior executive, you want a specific profile, I therefore care about the personal & strategic fit, the alignment of interests, the references & reputation of the fund, and the set of skills and experiences the VC Partner can bring on board."

6.2.3 Term Sheet & Shareholder's Agreement Considerations

100% of the entrepreneurs in the sample are sophisticated in their approach to the term sheet & SHA negotiation and do not stop at the valuation:

"I prefer raising money at a lower valuation, but with good terms & conditions than the opposite. To me, having really good terms is 10x better than having a good valuation." [Case 7]

Entrepreneurs' biggest gripe is liquidation preference. This term grates even more when investors do not use plain liquidation preference:

"Using liquidation clause is aggressive. These clauses are even worst when we are talking about participating preferred or when there is a multiple attached to it. Aggressive investors signal mistrust and the use of the worst forms of liquidation preference disincentivizes the founders." [Case 5].

This comment is in line with Chudzinski & Vouillon (2016), aggressive liquidation preferences can be demotivating to the founders.

Other loathed clauses were the vesting schedule reset, veto rights, and too stringent reporting obligations. Entrepreneurs were not all negative about the term sheet, they understand the VC mechanics:

“There is no free lunch; VCs want to protect themselves, they have commitment toward their LPs and want to achieve their target IRR and so doing they want to prevent the entrepreneur from making too many mistakes. Once you get that, you know that the aim of the term sheet is to reassure the investor and ensure there is a genuine alignment of interests. If you are good at executing your business and are able to deliver what you projected in your business plan, you should not even care about the aggressive terms the investor could impose because at the end of the day, it will be a win-win situation.” [Case 1]

The most lauded clauses were the provisions on the BoD, leaver and vesting clauses. Case 2 suggest that vesting clauses should be more common:

“I have been surprised when I found out that In Belgium and in the Netherlands founders and VCs were not heavy users of vesting provisions. Some entrepreneurs consider these clauses as unfriendly, but I actually think it should be generalized, especially at the very early stage. Vesting is protecting you from yourself and the other founders. Vesting can be instrumental in aligning the interests at the founder level.”

It can be noted that entrepreneurs understand the centrality of the term sheet & SHA in the investor-investee relationship, the importance of the alignment of interests and the need for a healthy power dynamics. It can also be noted that the quality of the term sheet & SHA can be used as a feature to differentiate between funds.

6.2.4 Venture Capital Activism and Channels used for Investor Relations

To use the terminology to be found in section 6.1.3: 0% of the startups in the sample have ‘interventionist’ lead investors, 37.5% of them have ‘available’ lead investors and 62.5% of them have ‘facilitating’ lead investors. The investors of the first group are hands-off most of the time but know when to step in and positively influence the management. According to the interviewed entrepreneurs, these moments revolve around strategic debates where the investors help the entrepreneurs thinking about the hardest problems, the active involvement at the board level and periodical monitoring.

The investors of the second group are more involved in the company. The entrepreneurs perceive their involvement in five areas: (i) the entrepreneur has numerous informal interactions (e.g. chat on WhatsApp, use of SMSs) with the investor; (ii) some strategic efforts are directly led by the investor (e.g. M&A, internationalization); (iii) the entrepreneur requests to be challenged by the investor; (iv) the entrepreneur actively leverages the resources made available by the investor (e.g. introductions for business development & recruitment purposes, interactions with other portfolio companies, etc.); and (v) the monitoring activities enable the investor to better understand the startup to provide more relevant value-adding activities. These interactions are all impelled by the management.

The entrepreneurs in the sample preferring 'available' investors have four characteristics: (i) below average expectations of the VC's value-add activities, (ii) a preference for solely interacting with their investors at the board level on strategic matters; (iii) a defensive profile characterized by a preference for their views taking precedence (in line with Busenitz et al., 1997) and the willingness to be trusted in their way of conducting operations and progressing on the business plan given their apparently strong business acumen/know-how (i.e. in the sample, these entrepreneurs were seemingly savvier: specific expertise, experience at a tier 1 consulting firm, serial entrepreneur, contrarian views on common management practices); (iv) besides formal reporting activities, investor relations heavily rely on the BoD.

The entrepreneurs in the sample preferring 'facilitating' investors have four characteristics: (i) above average expectations of the VC's added-value viewing the investor as a resource reservoir to be used as a performance-enhancing tool at the strategic and operational level; (ii) a development of a tight relationship with the investors characterized by almost daily interactions; (iii) an opportunistic profile ready to give up part of control for the sake of growth; and (vi) the BoD is not considered as the most effective channel for investor relations.

It can be understood that the diversity of entrepreneurs creates the need for diversity in terms of investors' approach, thus, the importance of matching the right entrepreneur with the right VC. These findings are in line with Guberna (2015) who highlighted the importance of both strategic & personal fit with the investor and Maula et al. (2009) and Sapienza (1992) who demonstrated the positive role of frequent social interactions in the investor-investee relationship as a key learning and relationship-building tool.

Case 2 shared his understanding on why entrepreneurs should have a careful understanding of their investors' activist style:

"Our investors are passive. They are available when we want to discuss strategic topics, and that's all in terms of involvement and that's a personal preference: I want my investors to be hands-off and I made it clear when we finalized their investment. […] Both hands-on and hands-off styles can have negative effects on a company, but it is a matter of expectations and alignment with the investor. Problems start when there is a difference in expectations: if an investor comes in and thinks he'll run the show, while the entrepreneur thinks he is going to run the show himself, and vice versa, that's where there are trouble."

It appears that the assumption about the importance of the alignment of interests and expectations, already shared by Arthurs & Busenitz (2003) holds true and is exacerbated when the investor exhibits a high degree of involvement. Two entrepreneurs in the sample illustrated that. For Case 6, the entry of small business angels into the capital slowed the growth of the startup. The entrepreneur and the business angels were not aligned on the startup's vision and this contribute to unpleasant situations with business angels actively requesting *"unnecessary reporting"* and involved in the day-to-day operations of the startup without having the necessary expertise:

"These business angels were not ambitious, they were losing themselves in the details and were pushing the company in the wrong direction; I am okay with listening to suggestions, but these suggestions must remain external advice, I must have the last word. Investors must understand when to back off."

For Case 2, the misalignment was in line with Bochner & Simmerman (2016) assumptions, his investor had a dual fiduciary and this conflict of interest revealed when the degree of activism increased over time:

"This investor was more and more active and was trying to influence us in raising a lot of cash in order to grow even faster. This was a dangerous game because it would be a highly dilutive effort for us. It turns out the investor had certain dynamics with his LPs and

the interest of his funds was not the best for us. Today, this investor is not sitting at the board anymore and his board seat has been converted into an observer seat."

6.2.5 Key takeaways

The entrepreneur's perspective on venture capital activism can be analyzed through the lens of Silveira & Wright (2016): the entrepreneur has an idea, a domain or technical ability, but lack the funding to grow and scale it, while the VC can provide the necessary funding and potentially additional inputs (i.e. the monitoring and value-adding activities).

In any case (even for the entrepreneur having bootstrapped his/her company so far), entrepreneurs contemplate venture funding as a way to accelerate growth. On the first level, VC is a capital provider and the perceived value of the VC is simply a function of the capital provided and the equity given up (i.e. the dilution). For that reason, the preliminary impact assessment of venture capital activism is neutral.

On the second level, the entrepreneurs can be split into two categories. In the first, entrepreneurs are leaning toward a positive perception of venture capital activism, so more hands-on investors. This inclination is due to a high perceived value of the additional inputs provided by the investor. In this case, the sum of the cash brought by the investor and his/her involvement in portfolio companies is greater than the mere value of the cash provided. This sum offsets the various costs incurred by the entrepreneur (i.e. reporting obligations, investor's control rights, investor's interference and the dilution reallocating the cash flow rights), put differently, having active investors offers a benign trade-off. These costs are in line with the VC's contracting mechanisms identified by Kaplan & Lerner (2010). In the second category, entrepreneurs are leaning toward a less positive perception of venture capital activism, so more hands-off investors. These entrepreneurs have a lower perceived value of the additional inputs provided by the investor. In this case, the sum of the cash and the investor's involvement is marginally greater than the value of the cash injection, and the associated costs might be too high to bear. This category is well illustrated by Case 3:

“My co-founder is a serial-entrepreneur and I have worked as a management consultant: we combine entrepreneurial experience and good business sense. I do not think having active investors would make much sense for us. […] In my opinion, it depends on the profile of the founders, if you are talking about dreamers (verbatim: ‘doux rêveurs’), they will need active investors there to guide them in the good direction and they should be ready to lose a bit of control for that, while for us, pragmatic and experienced guys, the value of smart money is lower.”

The opinion of Case 3 is in line with Kaplan & Strömberg (2004) who demonstrated that the greater the entrepreneur’s inexperience, the more severe the anticipation of agency problems, and so doing, the higher the likelihood of a VC actively involved in the portfolio company and Coppey (2016) assumption about the effect of VC’s value-add might have on their relationship with entrepreneurs: VCs relying heavily on ‘value-add’ as key value proposition are expected to predominantly attract and work with less experienced entrepreneurs while seasoned entrepreneurs are supposed to put less weight on the VCs’ ‘value-add’ and to focus more on the cash injection aspect of the VCs, not their post-investment involvement. There is, nonetheless, one significant *caveat* to the experienced vs inexperienced narrative. The assessment of ‘experience’ in the sample remains skewed by the subjective opinions of the interviewees and some might attribute this view to hubris (Busenitz el al., 1997).

The investor’s reputation and the trust-based relationship built with its associated alignment of interest potentially augment the aforementioned sum of cash injection and investor’s involvement.

An overview of the key takeaways related to the drivers and impact of VC activism in the frame of the investor-entrepreneur relationship is available in figure 18.

		1 The Venture Capitalist's perspective	2 The Entrepreneur's perspective
Level 1	Framework	Agency theory	The VC is no more than a capital provider
Level 1	Evidence	Term sheet considerations (e.g. board representation, vesting clauses) and active monitoring	The perceived value of the VC is a mere function of the capital provided and the equity given up (dilution)
Level 1	Outcome	Asymmetry of information reduction and downside protection as main outputs of activism	The preliminary impact assessment of venture capital activism is neutral
Level 2	Framework	The importance of a trust-based relationship for the 'value-add' capabilities	VC activism comes with an opportunity cost which value depends on the entrepreneur perception
Level 2	Evidence	Open communication, close relationship with the entrepreneur	Perception of activism = (cash injection + perceived value of the involvement) – the costs associated
Level 2	Outcome	A positive impact of venture capital activism and an enhanced investor-entrepreneur relationship	Negative vs positive preliminary impact of VC activism depending on the entrepreneur's perception
Level 3	Theoretical framework	Marketing & strategic differentiation	The importance of a trust-based relationship
Level 3	Evidence	Venture capital activism as a value proposition device to improve the dealflow	A trust-based relationship with open and informal communication eases the VC activism
Level 3	Outcome	Entrepreneur-friendly approaches and post-investment involvement provide a competitive advantage	Positively impacted VC's involvement and an enhanced relationship

Figure 18: ***Key takeaways from the interviews – Drivers and impact of VC activism*** *(Source: author's construction)*

7 Proposal of Recommendations for entrepreneurs and Investors

7.1 Setup

The primary purpose of this section is to introduce a proposal of recommendations for entrepreneurs and investors. Building on the interviews and the literature review, these recommendations take the form of a framework capturing the major forces identified in this paper; these forces are used to analytically match the right VC firm and its preferred activism style with the right entrepreneur's profile. The assumption being that a fit on a strategic, personal as well as, on the expected degree of venture capital activism standpoints, should be a catalyst of effective and value-enhancing investor-investee dynamics. This assumption is backed by this paper's on-field investigation and the literature that revealed a positive correlation between alignment on the perception of the dyad investor-investee relationship and the productivity of their collaboration (Busenitz et al., 1997; Isaksson, 2004; Turcan, 2008; Yitshaki, 2007).

To some extent, this framework is a direct answer to MacMillan et al. (1989) that suggested that VCs should understand their activism style, but overlooked the company perspective and the applicability of their findings.

In line with the literature, this paper builds on the premise that shareholder activism can have three-sided impacts: (i) value-adding, (ii) value-neutral and (iii) value-destructive. The source of ineffectiveness in the investor-investee relationship is, therefore, a function of the mismatch between expectations of activism, discord, and mistrust, and not the degree of activism *per se*. Clearly, the dyad investor-investee is proteiform and as a result, there is no 'one size fits all' approach. In a second phase, the framework serves to systemize the way to allocate the different governance devices to each associated pairs (i.e. match). These governance devices should be based on industry best practices (e.g. Guberna, 2015; Schreier, 2013, Teten et al., 2013; Tuck School of Business, 2003).

7.2 The Framework: a Company Perspective

7.2.1 The Reputation-Inputs Matrix: overview by quadrant

The framework takes a company perspective and is a 4-quadrants matrix with two dimensions (figure 19). The dimensions are expressed in variables that include the VC's reputation (y-axis) and the VC's inputs (x-axis). This matrix targets lead investors and VC-compatible entrepreneurs.

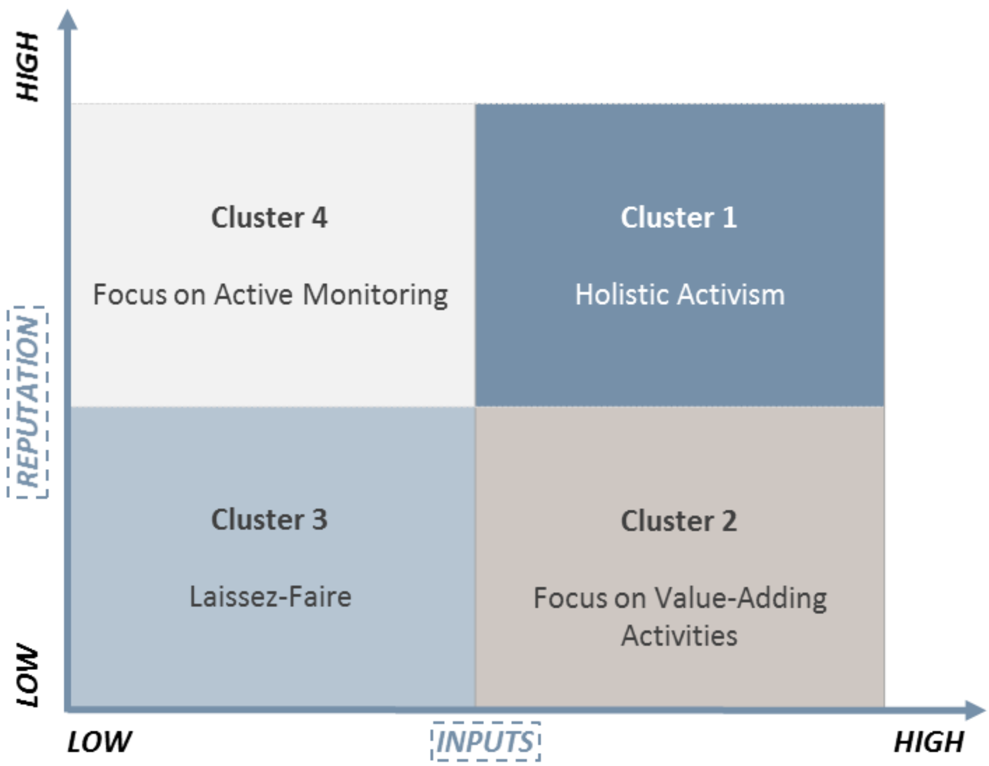

Figure 19: ***The Reputation-Inputs Matrix*** *(Source: author's construction; inspired by entrepreneurs Case 2 & 3)*

7.2.1.1 Cluster 1

VC with a high reputation coupled with high-expected inputs for the entrepreneur in question. The expected implication is a high degree of activism in both monitoring and value-adding activities (i.e. holistic activism).

7.2.1.2 Cluster 2

VC with a low reputation and high-expected inputs for the entrepreneur in question. The expected implication is a moderate degree of activism with a special emphasis placed on formal and informal value-adding activities, counterbalanced by lower reporting obligations confined to formal channels (e.g. at the board level).

7.2.1.3 Cluster 3

VC with a low reputation and low-expected inputs for the entrepreneur in question. The dyad investor-investee is limited to a financial relationship. The expected implication is a low degree of activism, the investor remains passive. Interactions remain formal.

7.2.1.3 Cluster 4

VC with a high reputation and low-expected inputs for the entrepreneur in question. Despite his/her presumably low inputs as an active investor for the entrepreneur, the VC has more bargaining power in the negotiation of reporting obligations and the involvement in monitoring activities.

7.2.2 Evaluation Dimensions

Table 4 introduces the relevance of reputation and inputs as chosen dimensions.

REPUTATION	INPUTS
Reputable VCs have a better performance in raising funds from LPs and have a stronger bargaining power In the terms negotiation with entrepreneurs (Hsu, 2004, Kaplan & Schoar, 2005).	In line with the lessons learned in the interviews, VCs provide financial and extra-financial inputs. The perceived value of the extra-financial inputs can differ from one entrepreneur to the other. There is no free lunch and partnering with a VC comes with an opportunity cost.

Table 4: ***Evaluation dimensions*** *(Source: author's analysis)*

7.2.2.1 Evaluation Variables

Each dimension of evaluation incorporates a set of variables that should be evaluated by scenario, thus, the dimension's result is determined by variable and only then by dimension. The two resulting scores (by dimension) include the dyad investor-investee in the matrix through the coordinates in the x-y axes.

7.2.2.1.1 Reputation Index – y

The reputation is positively impacted by: (i) the observable level of confidence placed by the LPs in the VC; (ii) the number of meaningful exits made by the VC; (iii) specific industry deal experience; and (iv) the quality of the current portfolio (Dealroom, 2018; Hsu, 2004). The reputation formula is detailed in figure 20. The end result can be assessed on an absolute basis taking the company perspective (i.e. dummy variable equal to 'yes' if the entrepreneur considers the VC a reputable after a thorough analysis).

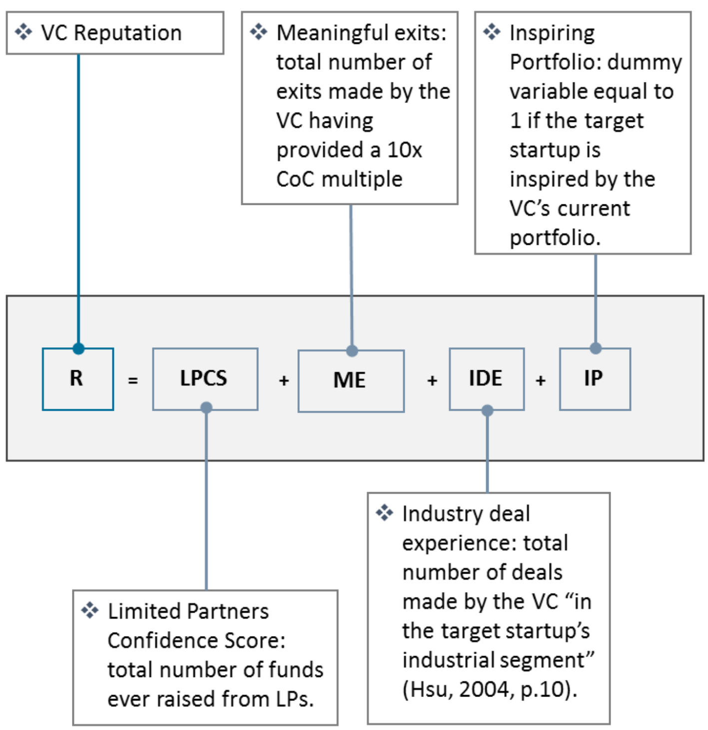

*Figure 20: **The Reputation formula** (Source: author's construction; inspired by Dealroom,2018, and Hsu,2004)*

7.2.2.1.2 Inputs Index – y

The inputs are impacted by: (i) the cash injection (positive impact); (ii) the smart money or the value-adding activities (positive impact); (iii) the governance engineering activities (positive impact); (iv) the dilutive effect of the transaction for the entrepreneur (negative impact); (v) the control terms negotiated by the VC (negative impact); (vi) the reallocation of cash flow rights (negative impact); and (vii) the reporting obligations (negative impact). The Inputs formula is detailed in figure 21. The end result can be assessed on an absolute basis taking the company perspective (i.e. dummy variable equal to 'yes' if the entrepreneur has high expectations for the VC's inputs).

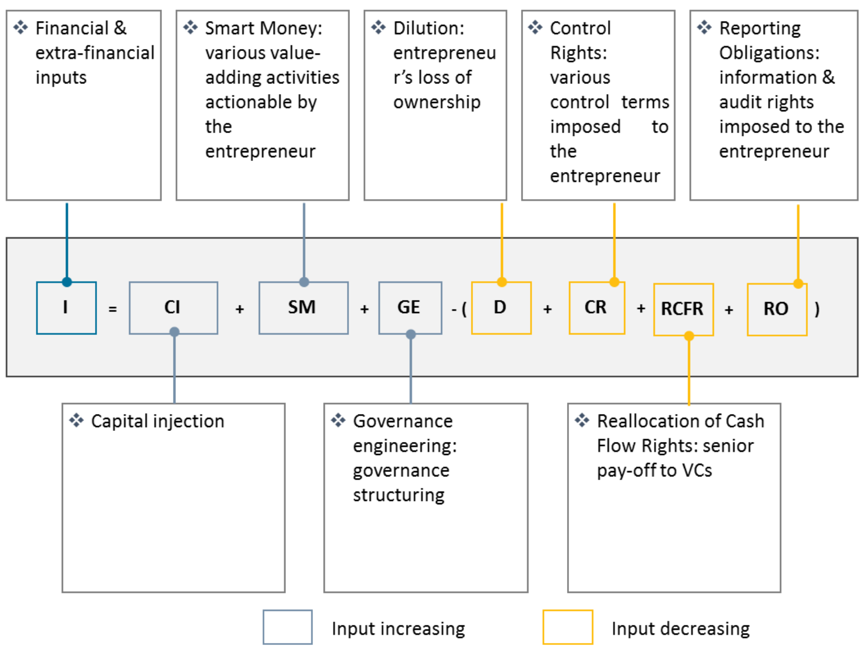

*Figure 21: **The Inputs formula** (Source: author's construction; inspired by Kaplan & Lerner, 2010)*

7.3 The Framework in Practice

Let's assume 'NewVentureCo', a VC-compatible Belgian startup involved in the B2B retail market. The startup has a prime coverage of the Belgian retail market, but lack resources to address the roll-out in other countries (absence of contacts abroad). NewVentureCo is raising €1.5m at a €6m post-money valuation to start the international expansion.

7.3.1 Scenario 1

NewVentureCo receives a term sheet from AcmeVC: a London-headquartered VC with offices in Paris, Berlin, and Stockholm. AcmeVC has invested in several unicorns, recently closed a new €100m fund, and has an expertise and a vast network of contacts in the retail industry.

Key terms of AcmeVC’s proposal: (i) appointment of a board member and a board observer by the VC, (ii) incentive schemes on three years targets, and (iii) investment with preferred stocks at a €4.5m post-money valuation – 33% ownership (against the initial founders’ view, the incentive scheme bridges the gap between the two if the targets are reached).

Reputation-Inputs Matrix assessment: high-reputation and high-expected inputs. The opportunity cost of the investment is moderate for the founders, but the expected value-adding activities to be provided by the VC (e.g. strategy definition at the board level, possibility to enter international markets) is very-well perceived by the founders. Both the founders and the investors are aligned on a high degree of VC involvement.

7.3.2 Scenario 2

NewVentureCo receives a term sheet from a first-time John Angel, a local Business Angel, with no contact in the retail industry.

Reputation-Inputs Matrix assessment: low reputation and low expectations of the inputs. Mr. Angel is expected to be a passive investor and the BoD will firstly be used as a device of information sharing. From the Matrix it could be derived that a high degree of activism of this investor would result in an unhealthy investor-investee relationship.

8 Conclusion

8.1 Overall Remarks

This dissertation started with the construction of the theoretical framework needed to grasp the challenges of a startup, the underpinnings, and drivers of the venture capital industry, and to be acquainted with the main mechanisms put in place to align the dyad VC-entrepreneur.

It became manifest that a startup is a young firm with specific challenges at hearth: growth, scalability and a heavy reliance on technology; all of this driving high funding needs (Blank, 2010; Damodaran, 2009; Graham, 2012; Manigart & Witmeur, 2012). Venture capitalists, with their capital collected from limited partners, are superseding the conservative bank loan industry to be considered as a key source of funding for startups (Manigart & Witmeur, 2012). Venture capital investing is a high risk / high reward game and, therefore, aims for investments with outsized returns (Sahlman, 2010; Wilson, 2009). When it is done well, venture capital is a formidable tool to support entrepreneurship, innovation and economic growth overall (European Commission, 2011; Kortum & Lerner, 2000; Popov & Roosenboom, 2009; Thiel et al., 2011).

At the same time, the industry has developed a number of customary mechanisms to align the sometimes conflicting interests of venture capital investors and startups entrepreneurs, to reduce the asymmetry of information and high-risk inherent to the uncertain environment of a startup. The document encapsulating the most these considerations is the term sheet (Burchardt et al., 2016; Grégoire, 2017; Kaplan & Strömberg, 2004; Lygnou, 2016; Wilmerding, 2006). On top of these elements, to reap higher rewards and to further reduce the risks and agency problems, venture capitalists are notorious for embracing an active role in portfolio companies. This post-investment involvement of the venture capitalist schematically takes two forms: monitoring and value-adding activities (De Clercq & Manigart, 2007; Ed-dafali et al., 2016; Hellmann & Puri, 2002; Jackson et al., 2012; Lerner, 1995; MacMillan et al., 1989). The board of directors is generally considered as the forum where venture capitalist can fully exert their influence on portfolio companies (Busenitz et al., 1997; De Vlaminck & Sarens, 2014; Guberna, 2015).

While the active profile of the venture capitalist has sparked the interest of many academics, there is no convergence over the empirical evidence of the net impact of the venture capitalist’s involvement and the literature remains vague on what is the right degree of investor’s involvement. Building on twenty-one interviews with European investors and entrepreneurs, this paper addresses this gap in the literature and has analysed the drivers of venture capital activism to understand what degree of investor’s involvement promotes effective and sound dynamics in the dyad investor-investee.

From the investor’s perspective, it can be derived that the venture capitalist’s post-investment involvement can be understood on three levels. On the first level, the drivers of activism are in line with the traditional agency theory framework, with the alignment of interest, asymmetry of information reduction and downside protection as main drivers. On the second level, a trust-based environment with open communication is a favourable context for venture capital activism and a healthy investor-investee relationship. On the third level, the need for differentiation in an increasingly competitive venture capital market (Pitchbook, 2018; Zhuo, 2018) is seen as a driver of venture capital activism. Placing the emphasis on the extra-financial contribution to portfolio companies is considered as a reputation-enhancing tool for emerging venture capitalists willing to compete with incumbent venture capitalists for the most promising investment opportunities.

From the entrepreneur’s perspective, venture capital activism can be understood on two levels. On the first level, the venture capitalist is nothing more than a financier, in this frame, the post-investment involvement cannot be considered as an essential topic. On the second level, venture capital activism has two competing outcomes for the investor-entrepreneur relationship: on the one hand, the entrepreneur has a positive perception of the investor’s involvement, on the other hand, the entrepreneur has a poor perception of the investor’s involvement. This poor perception stems from the fact that this involvement comes at a cost (e.g. investor’s interference, feeling of mistrust, reporting obligations, etc.).

Besides, the investor's reputation and a trust-based relationship built with its associated alignment of interest potentially augment the aforementioned perception of the investor's involvement. All in all, these interviews suggest that there is no 'one-size-fits-all' approach of venture capital activism and the effectiveness of the investor-investee relationship is not a function of the degree of involvement *per se*, but rather a function of the alignment on the expectations about the shape the investor-investee relationship will take at the post-investment stage.

To conclude, the paper provides a proposal of analytical tool to help the players to find a better alignment on venture capital activism, the assumption being that the more aligned the players are on the degree of expected involvement of the venture capitalist, the more effective their relationship will be. In this frame, the proposed analytical tool is a 4-quadrants matrix with the venture capitalist's reputation and the entrepreneur's perception of the financial and non-financial contributions of the venture capitalist as dimensions. As a result, the higher the score on these two dimensions, the higher the expected degree of venture capital activism. This proposal is still rudimental and it can be wondered to what extent it could be applied to real-life situations.

8.2 Limitations & Avenues for Future Research

There are several *caveats* to this paper and an outright generalisation of the findings would be a hazardous endeavour.

First of all, from a methodological standpoint, the sample used in this paper suffers from several flaws. It should be advised to researchers to conduct paired interviews with entrepreneurs and investors involved in the same venture. Furthermore, it would be interesting to enlarge the sample to two clearly defined sub-groups of entrepreneurs, (i) entrepreneurs who failed and, (ii) entrepreneurs who succeeded; to understand if venture capital activism has been one of the drivers of these outcomes. Moreover, it would be interesting to relate venture capital activism with the maturity/funding stage of the startup: a startup at the Series B stage is expected to have a more professional structure than a seed stage startup, having the stage of funding as independent variable would be a way to test if the VC's activist style is dependent of the maturity/funding stage of the target firm. Other variables could be inserted in such a model like the entrepreneur's experience in dealing with venture capitalists, the entrepreneur's entrepreneurial experience (serial entrepreneur vs first-timer), the entrepreneur's background (education, career, age, etc.), the presence of financial advisors (dummy variable), the VC's industry expertise, the VC's track-record, the VC's typology (e.g. independent VC vs CVC, French VC vs Belgian VC, seed-stage specialist VC vs later-stage specialist VC vs balanced VC, etc.) and the VC's risk appetite.

Second, this thesis' main finding is that the degree of investor's involvement itself is not the determinant of an effective investor-investee collaboration, but the alignment on the expectations is. However, relying on interviews colours the findings by the usual reporting biases. A triangulated analysis combining more than one research methods would have enabled the further validation of the first results (O'Donoghue & Punch, 2003). The author is content to leave it to future research to delve into the data and perhaps provide a more definitive perspective on venture capital activism. More specifically, researchers are invited to conduct a longitudinal study with a polarized sample of venture-backed startups with passive and active investors and to evaluate the impact of activism based on objective variables, such as accounting figures, valuation, performance at the exit, and the evolution of the headcount as a proxy for growth. Furthermore, while venture capital activism is an interesting topic to study, it would be insightful to statistically test the significance of the investor's involvement for portfolio companies; venture capital activism might be a subject of secondary importance.

Finally, the proposal of the matrix in this paper is not authoritative and should not be considered a bulletproof tool: it remains theoretical, rudimental, noisy, and is prone to profound improvements. The different assumptions and variables used to arrive to a score should be challenged to incrementally come up with a more realistic and actionable matrix. In addition, practitioners should test, improve, refine and update the tool on the basis of real-life examples.

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Appendices

1 Europe's most prominent VCs 2018 (top 10)

Company	Country	Notable investments in Europe		
Index Ventures		Revolut	deliveroo	TransferWise
ACCEL PARTNERS		Spotify	deliveroo	Doctolib
HV HOLTZBRINCK VENTURES		sum up	zalando	FLiXBUS
Northzone		Spotify	cornerjob GET A JOB IN 24 HOURS	iZettle
Balderton capital		Revolut	aircall	dubsmash
INSIGHT VENTURE PARTNERS		BlaBlaCar	HelloFRESH	showpad
ATOMICO		last.fm	pipedrive	Skype
LOCAL GLOBE		Citymapper	Zoopla	TransferWise
LAKE STAR		Spotify	Revolut	solarisBank
ROCKET INTERNET		Delivery Hero	Chefclub EDITIONS	TAKE EAT EASY

Note: ranking based on portfolio size, number of rounds in the LTM, number of meaningful exits (above €100m); Source: Dealroom (2018, p.3)

2 Point Nine Capital – Due diligence checklist

Point Nine Capital – Due Diligence ("DD")

As part of our DD we'd like to check the following items. Please note that this is our standard list, so not all questions may be applicable to you and in certain jurisdictions there may be special requirements. In case you're new to DD we've added some explanatory footnotes on the next page. If anything isn't clear, please feel free to ask at any time.

1. Corporate Structure

- Certificate of incorporation and/or current excerpt of the trade register[1]
- Overview of subsidiaries and minority participations
- Current cap table and historic development including beneficial holders in case of holding entities as well as encumbrances (if any)[2]
- Details of warrants, options, convertibles and other "equity-like" instruments such as SAFEs[3]
- Planned issuances of shares/share equivalents, esp. employee options[4]
- Agreements between the Company and any of its shareholders and/or directors

2. Material Agreements (also for affiliates if applicable)

- Agreements worth > EUR/US$ 25,000 p.a.
- Agreements related to real estate (e.g. rental contracts)
- Approximate costs in connection with funding round[5]
- Standard form(s) of customer agreements including terms and conditions
- Any other agreements material to the business of the Company or incurred outside the ordinary course of business

3. IP and Data Protection (also for affiliates if applicable)[6]

- List of all copyrights, patents, domain names and trademarks used or owned by the Company
- List of major components used to create company's product (including open-source, licensed software, and APIs) and agreements relating to IP and software licensed-in or out by Company
- Description of any disputes relating to IP or software (in court and outside of court, e.g. a claim made by email)
- Short description of data protection standards (esp. re customer data). Has the Company ever been approached by authorities about data protection?[7]

4. Employees (also for affiliates if applicable)[8]

- List of the Company's employees and consultants/freelancers, including title/position, start date, compensation (including vested/unvested option awards) and notice periods (if applicable)
- Employment agreements of key employees
- Employee benefit plans including (virtual) stock option plans
- Details of any pension and insurance plans set up or maintained by Company[9]

5. Basic Financials[10]

- Financial statements for prior year; most recent balance sheet and monthly management reporting
- Total approximate liabilities of the Company and its affiliates prior to costs connected to funding round
- Overview of any indebtedness and liabilities incurred outside the ordinary course of business[11]
- Financial plan for the next 18 months

6. Misc (also for affiliates if applicable)

- Overview of missed deadlines and disputes with tax authorities and tax payments outstanding[12]
- Details of ongoing or threatened legal disputes and administrative or regulatory proceedings

- Approval/registration/regulatory requirements to operate business; permits received to date and (potentially) required in the future
- Details of any government subsidies received or applied for
- Overview of known events or developments which could have a material negative impact on the business[13]

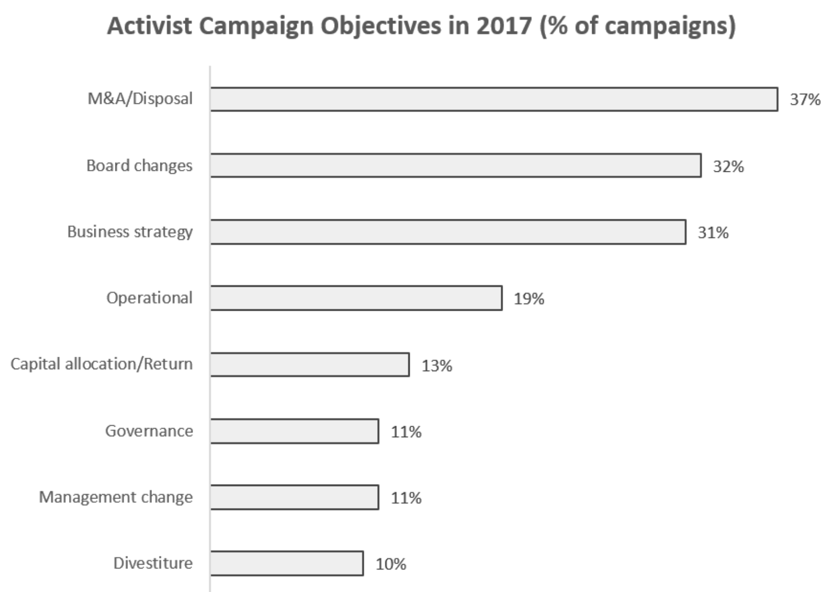
Source: Point Nine Capital (2018); retrieved from: https://www.dropbox.com/s/nlixqa6obir5jl0/Point%20Nine%20DD%20Checklist.pdf?dl=0

3 Historical performance of the VC asset class: overview of research

Author	Period covered	Geographics covered	Results
Dealroom (2018	2013-2015	Europe	Median CoC multiple: 2,8x
Cambridge & Associates (2017	1987-2017	United States	PME (S&P500): 11% CoC Multiple (Vintage Year 1988): 2,5x CoC Multiple (Vintage Year 2016): 1,0x Median IRR (Vintage Year 1988): 19% Median IRR (Vintage Year 2016): 2%
Xu (2004)	1993-2003	United States and Europe	US Alpha (CAPM): 3% EU Alpha (CAPM): 1%
Ljungqvist & Richardson (2003)	1981-2001	United States	Average IRR: 20%
Kaplan & Schoar (2005)	1980-2001	United States	Median IRR: 13%
Robinson & Sensoy (2013)	1984-2010	United States	Average IRR: 9%
Peng (2001)	1987-1999	United States	Average IRR: 55%
EVCA & Thomson Reuters (2013)	1980-2013	Europe	Net-pooled IRR: 2%

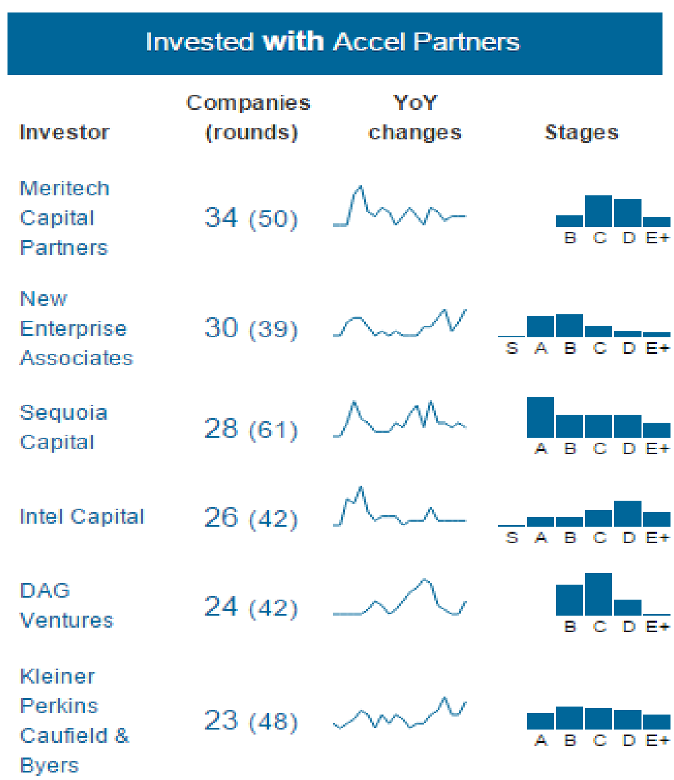
Source: summary produced by the author

4 Activist campaign objectives in 2017



Note: European and US listed firms with a market capitalization above $500m; Source: Lazard (2018, p.9)

5 Accel Partners' top co-investors



Source: CB Insights (2016, pic. 10)

6 The Galion Project's term sheet

Galion Term Sheet Serie A

Issuer	*Company [SA/SAS] (the "Company")*
Founders	*[__●__], [__●__] and [__●__] (the "Founders").*
Seed Investors	*[__●__][, [__●__] and [__●__]] (together the "Seed Investor[s]"), representing all pre-closing shareholders other than the Founders.*
Type of Security	*Series A [ordinary/preferred] shares (the "Series A").*
Structure of Financing	*The Series A round will amount to an aggregate of €[__●__] in newly issued Series A based on a fully diluted pre-money valuation of €[__●__], i.e., €[__●__] per share of Series A (the "Price"), allocated as follows (see Appendix A):*
Investors	*- [Investor 1]: €[__●__],* *- [Investor 2]: €[__●__],*
Closing Conditions	*(i) satisfactory completion of confirmatory due diligence;* *(ii) negotiation of customary legal documentation in compliance with this term sheet (including a simplification of the Company's by-laws, to the extent relevant);* *(iii) approval of the proposed investment/definitive agreements by the New Investors' respective investment committees or other competent bodies, if applicable;* *(iv) receipt by the Investors of anti-money laundering documents reasonably satisfactory to them;* *(v) receipt of waiver of any existing pre-emptive rights and/or other necessary approvals and consents;* *(vi) no unanticipated material adverse events.*

Liquidation Preference	*In the event of a liquidation, dissolution, winding up, merger, sale or other disposition of all or substantially all of the assets of the Company in which the shareholders do not own a majority of the outstanding shares of the surviving entity for a price (or value) per Company share, the higher of [20%] of the proceeds and par value shall first be distributed to all shareholders pro rata on an as-converted basis. Then, out of the remaining proceeds, the holders of the Series A shall be entitled to receive, in preference to all other shareholders, a per share amount equal to the Price (as adjusted for stock splits, combinations and anti-dilution adjustment) minus the amount received in the first distribution, plus any declared but unpaid dividends. Thereafter, the remaining proceeds (if any) shall be distributed pro rata to the holders of ordinary shares and Series A.*
Automatic Conversion	*The Series A shall automatically convert into ordinary shares upon the closing of a firmly underwritten public offering of shares of the Company with aggregate net proceeds to the Company based on a price per share at least equal to [5 times] the Price (a "<u>Qualifying IPO</u>").*
Optional Conversion	*Each holder of the Series A shall have the right to convert its shares at any time into ordinary shares. The conversion ratio shall be 1:1, subject to adjustment in the event of stock split or grouping.*
[Anti-dilution	*One anti-dilution equity warrant (a "Ratchet Warrant") will be attached to each Series A, entitling its holder to subscribe for a variable number of new Series A at par value in case a new round of financing shall be completed by the Company within [2] years of the Series A round at price below the Series A round, thereby obtaining an adjustment of the cost of such holder's shares based on a customary broad based weighted average ratchet formula; provided that holders of Ratchet Warrants shall only be entitled to exercise them to the extent that they participate in the relevant down round pro rata.]*
Redemption	*The Series A will not be redeemable consistent with applicable French law.*

Dividends	*The Series A shall be entitled to participate in any dividend distribution on a pro rata basis.*
Voting	*The Series A shall carry the same number of votes as the other shares of the Company issued and outstanding consistent with applicable French law[, except that shares held by the same shareholders for at least two years following the closing shall enjoy double voting rights].*
Series A Majority Approval	*The consent of holders of at least [2/3] of the Series A voting as a separate class shall be required for any action which alters or amends any of the rights, preferences or privileges of the Series A.*

A shareholders' agreement (the "Agreement") will be entered into on the Closing date among the Founders, the Seed Investors owning more than [5%] of the share capital and the New Investors, for a term of 15 years renewable. The Agreement will replace and supersede in all respect any and all pre-existing shareholders agreements entered into between the shareholders of the Company. The Agreement shall automatically terminate upon the listing of the Company's shares on a regulated market or a foreign stock exchange/ a Qualifying IPO.

All other shareholders including Seed Investors owning less than [5%] of the share capital and option holders (the "Minority Holders") shall sign with the parties to the Agreement (represented for this purpose by the Company) a separate, shorter shareholders' agreement under which the Minority Holders shall have a full tag along right in case of transfer of more than 50% of the shares of the Company and, in return, shall be subject to all major obligations provided for in the Agreement. Also, the Minority Holders will agree in such short-form shareholders agreement to be bound by the terms of any lock-up obligation which the banks in charge of the IPO and the Board may reasonably see fit.

Pre-emptive Rights	*The Founders for so long as they remain employed by the Company (the "Active Founders") and the New Investors shall have a pre-emptive right to purchase their pro rata share of any new securities of the Company other than securities issued to officers, employees, directors or consultants, shares issued for acquisitions or to strategic partners, in each case pursuant to plans or agreements approved by the Board.*
Lock Up	*No shares may be transferred by the Founders until the [third] anniversary of Closing, except for transfers by the Founders not*

	exceeding [15%] of their stake in the aggregate, Free Transfers, Leaver, Co-Sale and Drag Along situations.
Right of First Refusal	*The New Investors and the Active Founders will have a right of first refusal on any shares proposed to be transferred by any shareholder, with a right of oversubscription, except for transfers (i) to an affiliate entity, (ii) to the Company, (iii) to a fully own holding company for estate purposes or (iv) by any investment fund to a secondary fund in the context of the liquidation of the transferor ("<u>Free Transfers</u>"), in all cases subject to customary limitations and provided that the Active Founders shall have priority over any shares proposed to be transferred by the Seed Investors or the Founders.*
Co-Sale	*In case of a change of control or sale to an industrial acquirer not approved by the New Investors and Active Founders, all shareholders shall have a full tag-along right.* *The rights of first refusal and co-sale shall not apply to Free Transfers.*
Drag Along	*If a bona fide arms' length offer is made by any third party to acquire all of the shares in the Company, which is accepted by the holders of more than [75] % of the shares of the Company, all shareholders shall be required to sell their shares on the same terms and conditions subject to the Liquidation Preference. In this case, the rights of first refusal shall not apply.*
Liquidity	*The Company and its shareholders will use their reasonable best efforts to achieve a sale of the Company or initial public offering of its shares on a recognized stock exchange (an "<u>IPO</u>") on or before the 5th anniversary of Closing.* *If a liquidity event for the Series A has not been achieved by the [6]th anniversary of Closing, the holders of a [2/3] majority of the Series A then outstanding (the "<u>Investor Majority</u>") shall have the right, at any time following such date, to require the Board and shareholders of the Company to engage an internationally recognized investment bank in order to initiate a Qualifying IPO or sale of the Company; provided that (i) from the [six]th anniversary*

of Closing all shareholders shall be required to sell their shares to any acquirer having made an offer for 100% of the share capital of the Company which is accepted by the holders of at least a [2/3] majority of the Series A and (ii) this clause shall not be subject to the Right of First Refusal.

Information and Audit Rights	*Each New Investor holding more than [5%] of the shares shall be entitled to receive: (i) annual audited accounts for each group company and on a consolidated basis, together with the related auditors' report, within 4 months of the end of each year; (ii) semi-annual accounts for each group company within [45] days following the end of each semester; (iii) [quarterly/monthly] reporting within [45/30] days following the end of each [quarter/month]; and (iv) any change in the share capital or voting rights of the Company or any subsidiary thereof within [20] days of such change.* *Each New Investor holding more than [5%] of the shares shall also have the right, at its cost and subject to execution of a customary non-disclosure agreement, to visit the Company and inspect its books and records upon reasonable notice and during normal business hours.*

<u>BOARD OF DIRECTORS</u>

Board Representation	*The Company shall be managed by a board of directors (the "<u>Board</u>") of no more than [3-5] members.* *Each New Investor holding more than [15%] of the shares shall have the right to appoint one Board member or one non-voting Board observer who shall initially be [__●__].*
Board Meetings	*The Board will meet at least [2] times per quarter, at intervals not exceeding [2] months, with a minimum [8-day] prior notice except in case of urgency.*
Board Decisions	*All Board decisions shall be made at a simple majority of the members present or represented except for Material Decisions listed in <u>Appendix B</u> which shall be subject to a qualified majority of the Board including [at least 1 Investor director].*
[Management Rights	*The Company will execute a standard management rights letter that will give holders of Series A rights to consult with management sufficient to meet their venture capital operating company requirements.]*

Leaver	*[100]% of the shares held by Founders shall vest on a quarterly basis over a period of [three] years from Closing.* *In case of leave of a Founder before the [fifth] anniversary of Closing,* *(i) the Active Founders will have a call option for a period of 3 months over half of the unvested shares at their nominal value,* *(ii) the Company will have a call option for a period of 3 months over the other half of the unvested shares at their nominal value* *(iii) the Active Founders and the New Investors (pro rata among them) will have a call option for a period of 3 months over all other shares of the leaver at their then fair market value.* *As an exception to the above, in case of dismissal of a Founder for gross misconduct (faute lourde) before the [fifth] anniversary of Closing, all shares held by such Founder, whether vested or unvested, may be purchased at their nominal value.*
Employee Stock Option Plan	*Following the new round, an incentive plan for existing and future managers and employees of the Company will be adopted. This plan will represent [10]% of the Company's capital on a fully diluted basis after Closing. Each stock option will allow its holder to subscribe for one ordinary share at a price at least equal to the Price conditioned upon continued employment and standard vesting terms: 25% after one year and the balance on a quarterly basis over the following three years.*
Assignment of IP Rights	*The Closing shall be subject to the assignment of all intellectual property rights related to the business of the Company to the Company by the Founders or any entity controlled or owned by the Founders.*
Non-Compete/Exclusivity	*The Founders shall dedicate substantially all of their professional time to the Company for so long as they are in office and shall be bound by a customary 12-month non-compete obligation after that which may be waived by the Company and shall otherwise be compensated by monthly payments equal to [50%] of their average monthly salary during their last 12 months of employment.*
Documentation	*Definitive agreements shall be drafted by counsel to the Company and shall include customary representations and warranties of the*

	Founders who shall have the option to pay in cash or in shares of the Company and, in case of payment in shares, shall not be liable beyond the lesser of the investment amount and the value of their shares except in case of fraud. The documents other than corporate documents shall be in English.
Exclusivity	*The Company and the Founders agree not to solicit or receive any funding from any investors other than the New Investors for a period of 4 weeks from the date this term sheet is signed by the Company; provided that the New Investors shall promptly inform the Company of their decision not to pursue their proposed investment in the Company, as the case may be, in which case such exclusivity period shall immediately lapse.*
Expenses	*Upon transaction completion, the Company shall pay the New Investors' external fees and expenses incurred in connection with the transaction not to exceed €30,000 (before VAT) in the aggregate.*
Confidentiality	*The parties agree to treat this term sheet confidentially and will not distribute or disclose its existence or contents, except to their respective shareholders and professional advisors as reasonably required to complete the Financing.*
Applicable Law	*This Summary of Terms and the definitive agreements shall be governed and construed in accordance with the laws of France. Any dispute arising therefrom or in connection therewith shall be submitted to the exclusive jurisdiction of the commercial court of [place of incorporation of the company], France.*

Acknowledged and agreed:

[**COMPANY**]

By:_____________________________
Print Name:_____________________
Title:___________________________
Date:___________________________

[INVESTORS]

By:_____________________________
Print Name:_____________________________
Title:__________________________________
Date:__________________________________

[**FOUNDERS**]

By:_____________________________
Print Name:_____________________________
Title:__________________________________
Date:__________________________________

Appendix A - Cap table

Appendix B – List of Material Decisions subject to qualified Board approval

(i) effecting a merger, consolidation, sale of all or substantially all of the assets, or other reorganization of the Company (or a subsidiary) in which control of the Company (or a subsidiary) is transferred to a third party,

(ii) authorizing a liquidation or winding-up of the Company,

(iii) any material amendment, alternation or repeal of the Company's bylaws,

(iv) creating or authorizing the creation of any security senior to or on parity with the Series A (including any convertible into or exercisable for such series) or reclassifying, altering or amending any existing security that is junior to or on parity with the Series A, if such reclassification, alteration or amendment would render such other security senior to or on parity with the Series A,

(v) distributing dividends,

(vi) purchasing or redeeming any capital stock other than stock repurchased from former employees or consultants in connection with the cessation of their employment/services, at the lower of fair market value or cost,

(vii) any increase in the number of shares issuable pursuant to the Company's Stock Option Plan],

(viii) authorizing any financial commitment not provided for in the budget and greater than [20%] of remaining cash,

(ix) creating or authorizing the creation of any debt security and/or other borrowings not provided for in the budget and greater than [200k€] in aggregate,

(x) creating any subsidiary that is not a wholly-owned subsidiary,

(xi) increase or decrease the size of the Board,

(xii) any acquisition or disposition of assets (including but not limited to a majority or minority stake stake in another company) for value above [30%] of remaining cash,

(xiii) any transfer or license of the Company's technology or intellectual property rights outside the ordinary course of business,

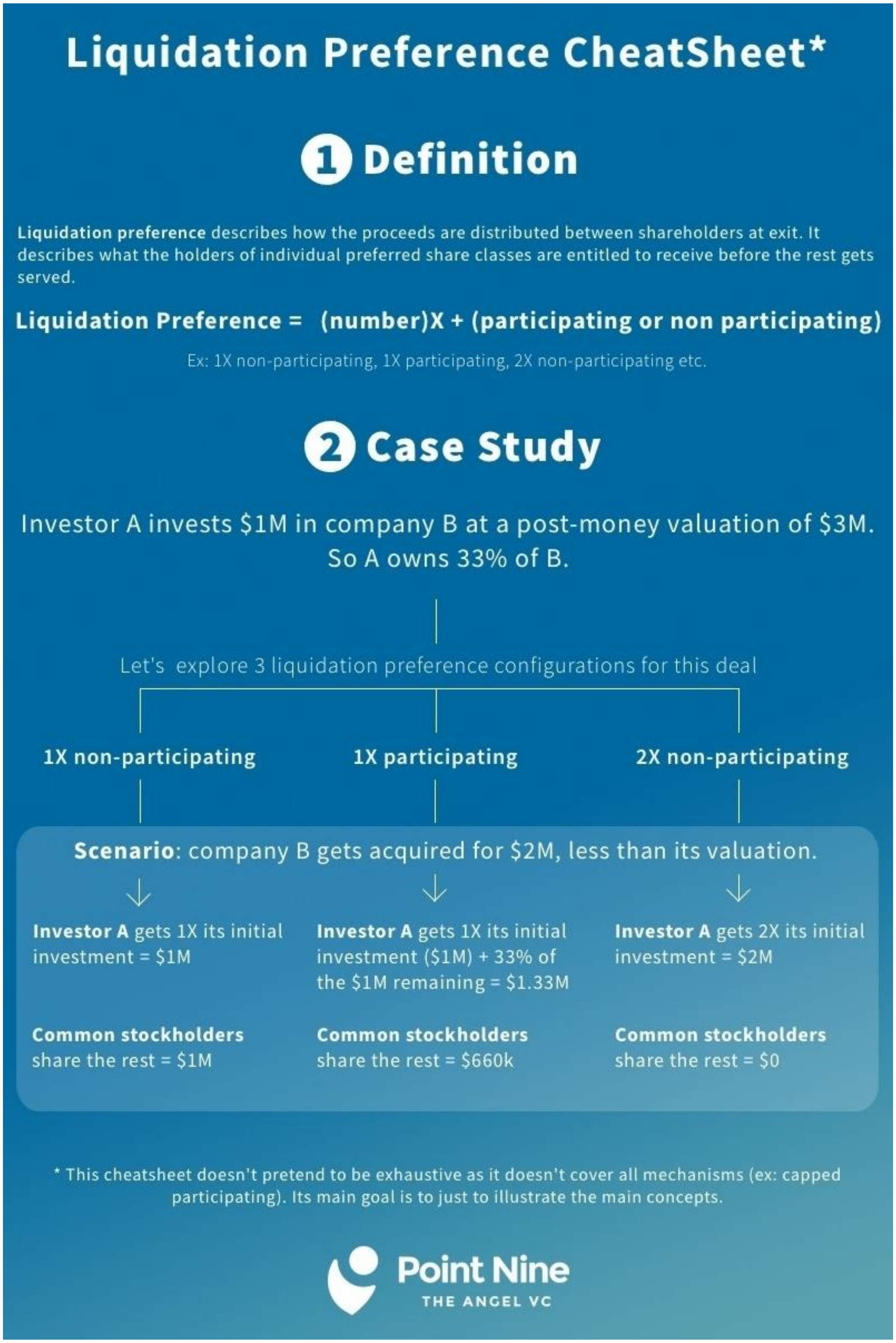
(xiv) undertaking an initial public offering or listing of Company shares,

(xv) any transaction between the Company and any officer, director or affiliate of the Company other than entered into at arm's length and in the ordinary course of business, or

(xvi) compensation or dismissal of each Founder.

Source: The Galion Project (2018, retrieved from: https://thegalionproject.com/term-sheet)

7 Liquidation preference cheatsheet



Source: Chudzinski & Vouillon (2016, retrieved from: http://pawel.posthaven.com/why-liquidation-preferences-can-make-your-startup-worse)

8 Investors sample

Company	Description	Country	Asset under management	Investment stage	Typical ticket size	LPs typology	Interviewee
Sunstone Capital	European early-stage venture capital firm investing in life science and technology companies		€341m	Seed, early stage	€200k - 7.5m	Institutional (university endowments, etc.)	- Name: Yacine Ghalim - Position: Principal - Education: HEC Paris, Bocconi University
partech	Global VC firm investing at the seed, venture, and growth stages across Europe, US, Africa and a bit of Asia		€ 1.6bn	Stage agnostic	€200k - €50m	Institutional (e,g, Groupama), corporate (e,g, Carrefour), Family offices/Business angels	- Name: Boris Golden - Position: Principal - Education: Ecole Polytechnique (X)
VOLTA VENTURES	Venture capital firm that offers seed & early stage VC for internet & software companies in the Benelux		€ 55m	Seed, early stage	€200k - 2.5m	Business angels/family offices, governmental agencies (e.g PMV)	- Name: Leonard Soenen - Position: Associate - Education: KU Leuven, Vlerick
Belgian Media Ventures	Belgian Media Ventures offers the concept of "Media for Equity", offering media campaigns for young SMEs using the media provided by RTBF in exchange for a capital investment		Unknown	Unknown	Unknown	Corporate (Belgian Media ventures is a subsidiary of Régie Media Belge)	- Name: Sophie de Jaer - Position: Investment Manager - Education: Université Libre de Bruxelles (Solvay)
inventures impact venture capital funds	Venture capital fund that builds a better world through a portfolio of investments in sustainable businesses		€40m	Early-stage and growth-stage	€250k – 1m	Unkown	- Name: Peter De Decker - Position: Senior Associate - Education: KU Leuven
iA internet Attitude	Investment fund specializing in support and financial assistance to companies in the Internet and mobile applications		€10 m	Seed	€150k - 1.5m	Business angels	- Name: Christian Castelain - Position: Administrator - Education: UCLouvain
finance.brussels brustart	Venture capital arm of finance.brussels (ex SRIB), the public financing structure of Brussels-Capital Region		€130m	Seed to expansion stage	€50k – 5m	Government, institutional (e.g. P&V Assurances, Belfius)	- Name: Corentin Scarcez - Position: Investment Manager - Education: Université Libre de Bruxelles (Solvay)
BVA BELGIAN VENTURE CAPITAL & PRIVATE EQUITY ASSOCIATION	Belgian Venture Capital & Private Equity Association is a trade association that caters to the Belgian PE and VC community		n.a.	n.a.	n.a.	n.a.	- Name: Pierre Demaerel - Position: Secretary General - Experience: Banking and Private Equity - Education: KU Leuven, Vlerick
BlackFin Tech	BlackFin Tech is a European VC fund focusing on fintech & insuretech, managed by the PE firm BlackFin Capital Partners		€180m	Multi-stage from the Series A funding round	€1 – 10m	Institutional (e.g. financial institutions, sovereign), funds of funds, family offices	- Name: Romain Grimal - Position: Associate - Education: HEC Paris
EQT VENTURES	EQT Ventures is a multi-stage venture capital fund investing in Series A, B and C in primarily European focused tech companies		€566m	Multi-stage from the Series A funding round	€3m – 75m	Institutional (e.g. sovereign, pension funds)	- Name: Bartosz Jakubowski - Position: Venture Lead - Education: HEC Paris, Ecole Polytechnique (X)
Fund+ Profit Growth People	Fund+ is an open-ended Fund for long term equity investment in innovative Life Sciences companies with a focus on Belgium		€125m	Unknown	€3 – 10m	Business angels, family offices, governmental agencies	- Name: Chris Buyse - Position: Managing Partner - Education: Universiteit Antwerpen, Vlerick
PROFINPAR	Profinpar is a fund of entrepreneurs, venture capital investors whose approach focuses on active partnerships with SMEs. Profinpar invests in Belgium, Luxembourg and the north of France		€38m	Growth, mezzanine, late stage capital	Minimum €2m	Business angels/family offices, institutional (Belfius, SFPI-FPIM)	- Name: Thomas Walgraffe - Position: Partner - Education: UCLouvain, INSEAD

Note: BVA is not an investment fund. Source: Interviewees as primary source, completed by the companies' websites and Dealroom

9 Entrepreneurs sample

Company	Description	Country	Total funding	Investors typology	Date founded	FTEs	Interviewee
Qapa.fr	Qapa is a job matching marketplace that connects temporary workers and recruiters with a matching algorithm		€13m	International and French VCs (e.g. Partech, Index Ventures)	2011	68	- Name: Stéphanie Delestre - Position: Co-founder & CEO - Education: Paris-Sorbonne University, ESCP Europe
wooclap	Wooclap is a web-based solution to boost interactivity with your live audience during a conference, class or corporate meeting		€350k	Business angels, governmental VC (WING)	2014	14	- Name: Sébastien Lebbe - Position: Co-founder & CEO - Education: Université Libre de Bruxelles (Polytechnique & Solvay)
Side ex-WeSlash	Side is on a mission to create the smoothest work experience, matching company's temporary needs with qualified profiles within seconds		€ 6.3m	Business angels (e.g. Xavier Niel), French and International VCs (e.g. Kima Ventures, Aglaé Ventures)	2016	30	- Name: Pierre Mugnier - Position: Co-founder & CEO - Education: HEC Paris
neveo	Neveo consists in a family network that allows elder to be connected to all his/her family members. With one click, send photos and messages on a family newspaper that your senior will receive every month		€ 1.5m	Belgian VC (Lean Fund), business angels (Be Angels), governmental VC (WING)	2015	3	- Name: Vincent Leroy - Position: Co-founder & CEO - Education: Conservatoire National des Arts et Métiers
Andaman7	Andaman7 combines: for doctors, an electronic health record and for patients, a personal health record. In addition to this, we have built a solid platform to seamlessly connect them and ensure that health data is securely exchanged for better diagnosis		€2.2m	Business angels (e.g. Bernard Delvaux), Belgian VC (Lean Square), governmental VC (Meusinvest)	2014	24	- Name: Vincent Keunen - Position: Founder & CEO - Education: Université de Liège
tilkee	Tilkee is a cloud based app that increases sales team's closing rate and optimizes prospects follow-up by tracking business proposals		€4.0m	Corporate VC (e.g. Crédit Agricole), French VCs (e.g. Omnes Capital)	2013	32	- Name: Sylvain Tillon - Position: Co-founder & CEO - Education: EMLYON
idloom	Idloom optimizes professional organizations by simplifying internal communication and processes		Bootstrapping	n.a.	2015	5	- Name: Sébastien Braun - Position: CEO & Founder - Education: UCLouvain (Louvain School of Management)
DataCamp	DataCamp is an interactive learning platform for data science. Learn R, Python, SQL & Spark from the comfort of your browser		€5.8m	Business angels, US VCs (e.g. Arthur Ventures), accelerator (Techstars)	2013	78	- Name: Jonathan Cornelissen - Position: Co-founder & CEO - Education: KU Leuven
euroQuity Sowalfin	EuroQuity is a cross-border platform created to match growth companies with investors and advisors. The service is operated by Bpifrance in France and by Solwalfin in Belgium		n.a.	n.a.	2008	n.m.	- Name: Christine Margreve - Position: Manager EuroQuity Belgium - Education: FUCAM

Note: EuroQuity/Sowalfin is not a startup. Source: Interviewees as primary source, completed by the companies' websites and Dealroom

10 Interview guide for investors

Interview Investor

Thank you for helping Louvain School of Management (UCLouvain) learn about venture capital. Your response will help us to learn best practices in venture capital, entrepreneurship and guide academic research. Please let me know if you are opposed to an audio recording of this interview. Your responses are strictly confidential and will be used only for noncommercial research purposes. If interested, I will give you an early look at the complete thesis. Thank you!

<u>Introduction</u>

- Could you introduce me to your company?
- What is your role in this company?
- In terms of investment, what is your investment thesis?

<u>The fundraising process and deal structuring</u>

- What are the most important factors when deciding whether to invest?
- What term sheet items are you flexible on when negotiating with an entrepreneur and which items not? Why?

<u>Post-investment relationship</u>

- After the investment, what is your role in the venture?
- Besides money, how do you add value to portfolio companies?
- How frequently do you interact with the entrepreneur?
- Do you consider yourself as an active investor? If so, do you think this level of involvement contributes to startup's success?
- Would you rather be a hands-on or hands-off investor?
- What is your motive as active investor? Is it your way of exercising control over your investment or your way to improve the venture for the benefit of all stakeholders?
- What was your first reaction when you saw the dispute at Uber Technologies leading the CEO Travis Kalanick to resign under investor pressure?

<u>Recommendations</u>

- Is there anything important we haven't discussed and you would like to address?
- Do you know any entrepreneur or business angel/VC I could get in touch with for a similar interview?

Source: produced by the author, inspired by Gompers et al. (2016)

11 Interview guide for entrepreneurs

Interview Entrepreneur

Thank you for helping Louvain School of Management (UCLouvain) learn about venture capital and the drivers of entrepreneurial firms' success. Your response will help us to learn best practices in venture capital, entrepreneurship and guide academic research. Please let me know if you are opposed to an audio recording of this interview. Your responses are strictly confidential and will be used only for noncommercial research purposes. If interested, I will give you an early look at the complete thesis. Thank you!

<u>Introduction</u>

- Could you introduce me to your company?
- What is your role in this company?
- What is your current development stage and what are the next steps?

<u>The fundraising process and deal structuring</u>

- What was the company's situation prior to the entry of professional investors? (business angels and VCs)
- What was your motivation to look for external equity financing?
- What are the most important factors when deciding which investor to partner with?
- What term sheet items are you flexible on when negotiating with an investor and which items not? Why?

<u>Post-investment relationship</u>

- After the investment, what is your investor role in the company?
- Besides money, what is the investor's added-value?
- How frequently do you interact with the investor?
- Do you consider the investor as active? If so, do you think this level of involvement could have adverse effects on a company?
- Would you rather have hands-on or hands-off investors?
- According to you, what is the investor's motives? Is it the investor's way of exercising their control over the company or their way to improve the company for the benefit of all stakeholders?
- What was your first reaction when you saw the dispute at Uber Technologies leading the CEO Travis Kalanick to resign under investor pressure?

<u>Recommendations</u>

- Is there anything important we haven't discussed and you would like to address?

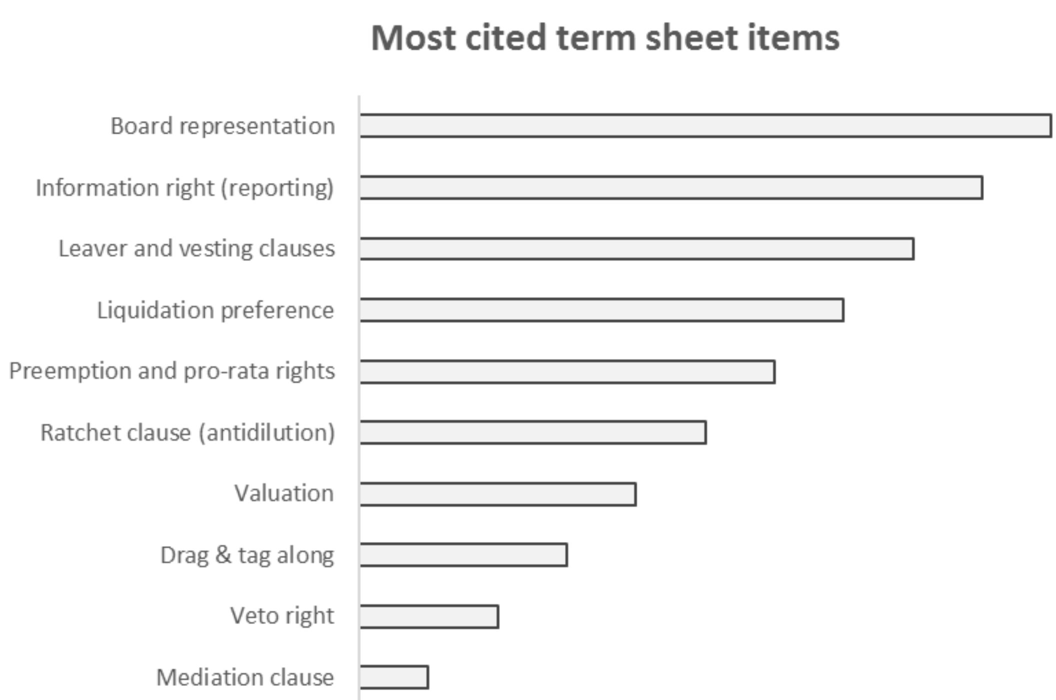
- Do you know any entrepreneur or business angel/VC I could get in touch with for a similar interview?

Source: produced by the author, inspired by Gompers et al. (2016)

12 Most important factors when deciding whether to invest

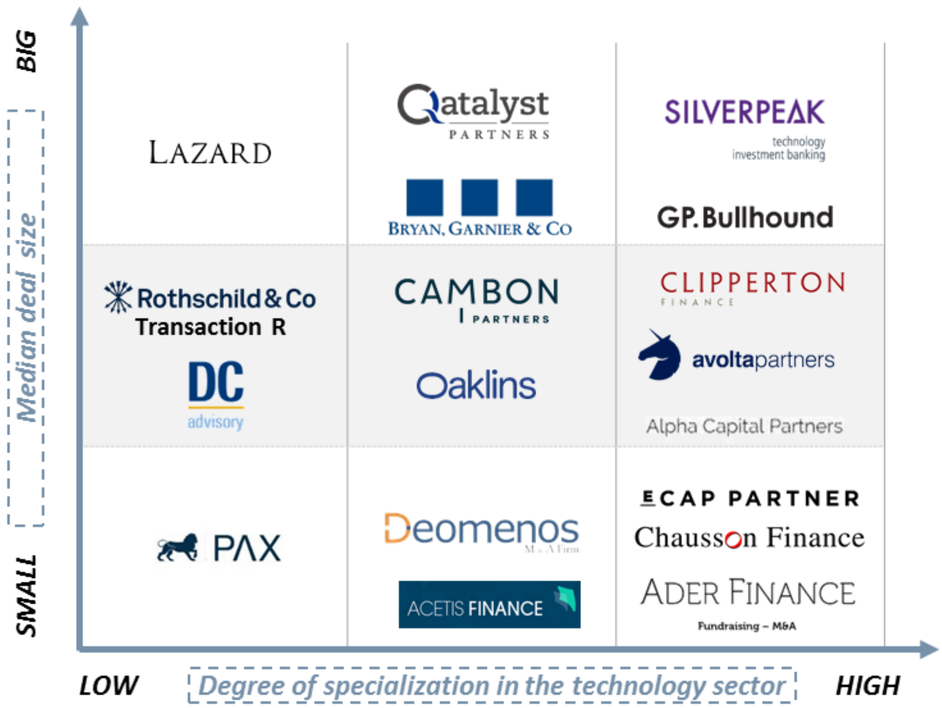
Source: interviews

13 Most commonly used terms



Source: interviews

14 Main financial advisors involved in the French fundraising ecosystem



Note: non-exhaustive; Source: author's analysis

15 League table 2017 – Most active financial advisors – VC deals

Ranking	Company	Deal Count	Value (€m)	Deal sample	
1	Alpha Capital Partners	10	84	EASY RECRUE	back market
2	avoltapartners	10	80	Julie Desk	Minuit Une
3	CLIPPERTON FINANCE	9	120	Glovo	sendinblue
4	CAMBON PARTNERS	7	76	Qwant	Chefclub Network
5	Rothschild & Co Transaction R	6	76	*Undisclosed*	
6	Chausson Finance	4	24	Adrenaline Hunter	meero
7	ADER FINANCE Fundraising – M&A	3	11	Liegey Muller Pons	Feed.

Source: Avolta Partners (2018)

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