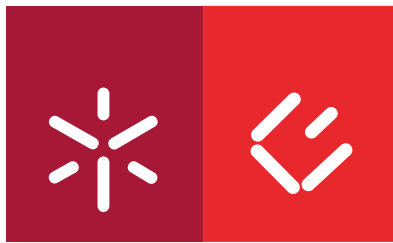


Universidade do Minho
Escola de Economia e Gestão

Maria Luísa Fernandes Lopes

**Venture Capital in Portugal:
investments' selection criteria,
intervention forms and impact on
venture capital backed firms**



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Master Dissertation in Management

Supervisor:

Professora Doutora Maria do Céu Cortez

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Anexo 2

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Abstract

Venture Capital is a source of funding that promotes both firms' development and competitiveness, not only by providing capital but also by supporting management in a variety of fields. The Portuguese Venture Capital market is a recent one and there are few studies regarding it. Our survey attempts to contribute to a deeper understanding of this activity in Portugal, through a current view about the selection criteria of investment opportunities, the Venture Capital firm intervention during the partnership and the impact on the Venture Capital backed companies after the divestment. We intend to study the Venture Capital evolution over the last years, by comparing our findings with those obtained by Correia (2004). Furthermore, we aim to examine the impact that the financial crisis has had on Venture Capital.

The study was conducted through a content analysis of ten semi-structured interviews with Portuguese Venture Capital managers. We find evidence that there is a positive development in the Venture Capital broadening in Portugal. The Portuguese Venture Capital market has firms with several investment profiles that determine their preferences in the projects' selection. Nevertheless, the management team's characteristics are mentioned as a relevant criterion by the majority of Venture Capital managers. The exit strategy is one of the major concerns of Venture Capital managers throughout the different stages of the investment cycle. The Venture Capital firm conducts a close monitoring of the portfolio companies particularly when it comes to decisions that may change their strategy. The partnership between the Venture Capital and the entrepreneur is vital for an achievement of a more professional management.

Keywords: Venture Capital; Venture Capital backed Company; Investments Selection; Intervention; Exit; Business Impact

Resumo

O Capital de Risco é uma fonte de financiamento que promove o desenvolvimento e competitividade das empresas, não só através da injeção de capital, mas também de apoio a vários níveis. O mercado de Capital de Risco é recente em Portugal, existindo pouca informação e estudos sobre o mesmo. Este trabalho de investigação visa contribuir para o conhecimento da atividade em Portugal. O propósito desta investigação é o de obter uma visão atual sobre os fatores de seleção de oportunidades de investimento, as formas de intervenção das Sociedades de Capital de Risco durante a parceria e o impacto nas empresas participadas após o desinvestimento. Pretendemos ainda observar a evolução da atividade de Capital de Risco nos últimos anos, através da comparação dos resultados com os obtidos por Correia (2004). Adicionalmente, propomo-nos estudar o impacto que a crise financeira tem no Capital de Risco.

O estudo fez-se através de uma análise de conteúdo de dez entrevistas semi-estruturadas a gestores de Sociedades de Capital de Risco Portuguesas. Constatou-se que houve uma evolução positiva na divulgação de Capital de Risco em Portugal. Existem, no mercado Português, Sociedades de Capital de Risco com diversos perfis de investimento, o que determina as suas preferências na seleção de projetos. A maior parte dos gestores de Capital de Risco destacam a importância das características da equipa de promotores como critério para a seleção de investimentos. A saída do investimento é um dos aspetos que mais preocupa os gestores de capital de risco ao longo de todas as fases do processo. A Sociedade de Capital de Risco faz um acompanhamento próximo da empresa sobretudo em matérias que possam alterar a sua estratégia. O impacto da parceria é determinante para tornar a gestão mais profissional.

Palavras-chave: Capital de Risco; Empresa participada; Seleção de Investimentos; Intervenção; Saída; Impacto no Negócio

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1. Introduction

The following study is intended to contribute to further knowledge concerning the Venture Capital¹ industry in Portugal, particularly with respect to the criteria and procedures used by Venture Capitalists in selecting investments, their intervention during the partnership and the impact on the VC backed firms after divestment. Our interest in this topic is due to the wide potential that the VC industry is believed to have in creating jobs and wealth, by promoting firms' development and improving their competitiveness.

Since the 20th century, VC has played an essential role in many countries' economy by fund-raising, fund-management and financing companies with high growth potential (Snieska and Venckuviene, 2009). This source of capital is different from others, as the Venture Capitalist becomes a partner and provides capital and management support according to the company's development needs. This peculiar feature of VC activity is unique in that it creates value for firms and their stakeholders, as well as for the investors who put their capital in the fund and expect an adequate return according to the level of its risk.

With its beginnings in the United States after World War II, VC is now widely present in several countries around the world (Duarte, 2006; Hege, Palomino and Schwienbacher, 2009). It is worth to note that some of the most successful companies in the world were somehow financed by VC, for instance, Intel, Apple Computer, Federal Express, Microsoft, Cisco Systems and Staples Inc. Businessland, to list just a few (Félix, Gulamhussen and Pires, 2007). In Portugal, the industry is much more recent, with nearly twenty years, as the VC market is still small. Thus, there is a dearth of available information for analysis and published research on the Portuguese VC industry (Félix, Esperança, Gulamhussen and Pires, 2009). An empirical study carried out by *Associação Portuguesa de Capital de Risco* (APCRI)² pointed out that there has been no concern among operators in analyzing the impact of this activity on the VC backed firms, which is of particular relevance in an economic crisis framework (APCRI, 2009). Klonowski (2006) states that despite the increasing number of academic studies regarding the VC industry in recent years, mainly in the Central and Eastern Europe, the broadening of this topic is still relatively weak. As Félix, Esperança, Gulamhussen and Pires (2009) argue, a lot of work needs to be done in order to attract new

¹ Venture Capital will be labeled hereafter as "VC".

² APCRI is the Portuguese Venture Capital Association.

entrepreneurs and create a culture with less risk aversion in Portugal capable of exploring the benefits of the international VC flows.

In recent years, the VC market in Portugal has been characterized by the growing number of VC firms, the increasing average value of investment and divestment by participated company, the rising investment on early-stage and the growing weight of funds in financing the activity (*Newsletter APCRI, 2009*).

In 2007, Portuguese VC firms' investments amounted to 227 million Euros and, in 2008, 396 million Euros. It is reasonable to argue that there is a remarkable growth between the two years, given the slowdown of VC activity in Europe (*Anuário APCRI 2008-2009*). In 2009, there was a decline in the sector, with a total investment of 303 million Euros. In 2010, a considerable decrease of 46% was observed, as the VC investment in Portugal declined to 164 million Euros. This performance was explained by APCRI as being the consequence of the funding contraction, which contributed to the suspension of several VC initiatives, the lack of liquidity and the fact that entrepreneurs have frozen their investment policies. Notwithstanding, experts believe that VC has plenty of room to grow as a huge source of funding during periods of crisis, since the commercial banks are restricting access to credit and are less willing to support projects with higher risk. VC is essentially geared towards SMEs (Small and Medium Enterprises), which constitute the majority of the Portuguese business community (*Newsletter APCRI, 2011*).

Pereira (2008) contends that the Portuguese VC market's growth has been constrained by a number of factors: the reduced market size leading to lack of liquidity; absence of international investors and shortage of good investment projects; the Portuguese business culture being unfavorable to the development of the sector because of the low openness of SMEs to entrance of new partners; lack of firms' ability in presenting structured business plans; absence of well trained managers; existence of unclear rules; undemanding investors; and lack of entrepreneurship. Correia (2004) proposes several important reasons for the difficult access of Portuguese firms to VC: lack of clearness between personal and firm's property; misconceptions about VC; total unawareness of VC firm's investment preferences;

poorly structured business plans with unrealistic assumptions; over in-debt companies; fear of losing property; fear of losing control and rejection of Venture Capitalists' recommendations.

To the best of our knowledge, there is some criticism expressed at the VC intervention in Portuguese companies, specifically due to the excessive dependence on economic cycles, lack of experience in venture investments which is reflected in management monitoring and the limited exit possibilities (Duarte, 2006). However, more than two decades after the beginning of the activity in Portugal³, there is clearly a new cycle of the industry development as a result of the growing presence of private investors' in the market. They are more dynamic and demanding, bringing with them a new positive image of VC (Duarte, 2006).

We intend to contribute to a better understanding of VC in Portugal and examine its evolution over the years through an update of Correia's (2004) study, which based its findings on gathered experiences from Portuguese Venture Capitalists. We believe that as it is important to replicate this study considering further research that has emerged in this area, it is equally vital to analyze the impact of the global financial crisis on this sector. Since academics (Correia, 2004; Félix, Esperança, Gulamhussen and Pires, 2009) have stated that the company owners often display fear of losing power and control over the company when dealing with VC, it is also important to reveal the activity patterns in the Portuguese business communities while exploring the partnership between the company and the Venture Capitalist. Thus, the present study encompasses the analysis of VC investment – pre-investment, investment and post-investment stages – taking into account the perceptions expressed by Portuguese VC managers. At the pre-investment stage, we intend to analyze the criteria and procedures considered by Venture Capitalists in the investment's selection; at the investment stage, we aim to discuss how the VC firm intervenes in the company during the partnership; finally, at the post-investment stage, we propose to examine the impact on the VC backed firms after divestment. We begin by conducting a literature review with a relevance to the framing of this issue. In the next stage, we describe the analytical framework and methodologies applied, as well as the data collection process through semi-structured

³ The VC activity in Portugal was first regulated by Decree-Law n.º17/1986 of 14th June.

interviews with Portuguese VC managers. Subsequently, we present the results through a set of tables, an explanatory framework and some opinions of those interviewed, seeking to convey the information as objectively as possible. The discussion of the results also takes into consideration the study conducted by Correia (2004). Finally, we outline the main findings, identifying some limitations of the current study and suggest avenues for future research.

2. Literature review

2.1 What is Venture Capital?

In order to perform its investment projects, every company needs funding. VC⁴ is a source of funding derived from a VC firm, VC fund or an individual investor⁵ (business angel) which acquires a minority ownership in the subsidiary company, becoming a reliable medium/long term partner. The Venture Capitalist actively assists the management team of the investee company, with the objective of supporting its growth (Fulghieri and Sevilir, 2009). Later, the Venture Capitalist alienates its capital share by an amount that repays the investment, achieving an adequate return to the level of risk (Kaplan and Stromberg, 2001).

The VC investment does not require the payment of financial charges, neither the provision of real or personal guarantees. The investor's profitability only depends on the investee's success, and is accomplished by capital gains in the moment of divestment. In this sense, VC investors look for companies with high growth potential in promising markets (Faria, 2009). The partnership with a renowned VC firm increases the investee company's credibility, besides adding professionalism and accuracy to management (Smith, 2001; Faria, 2009; Fitza, Matusik and Mosakowski, 2009). VC provides capital to firms that might otherwise have difficulty in attracting funding because these are small and young firms, with few tangible assets and typically operate in markets that change very quickly (Gompers and Lerner, 2001; Kaplan and Lerner, 2010).

⁴ According to Decree-Law n.º3757/2007, 8th November, "it is considered a venture capital investment the acquisition, for a limited period of time, of capital instruments in companies with high development potential as way to benefit from its recovery".

⁵ Decree-Law n.º3757/2007, 8th November, regulates the activity of VC investment through: VC firms; VC funds; and VC investors (business angels).

2.2 Venture Capital investment types

Venture Capitalists have different investment profiles, which are often related with the development stages of the companies they invest in, enabling them to better analyze the potential risks and gains (Faria, 2009). Considering this, we can distinguish several types of investments (Faria, 2009):

2.2.1 Early stage

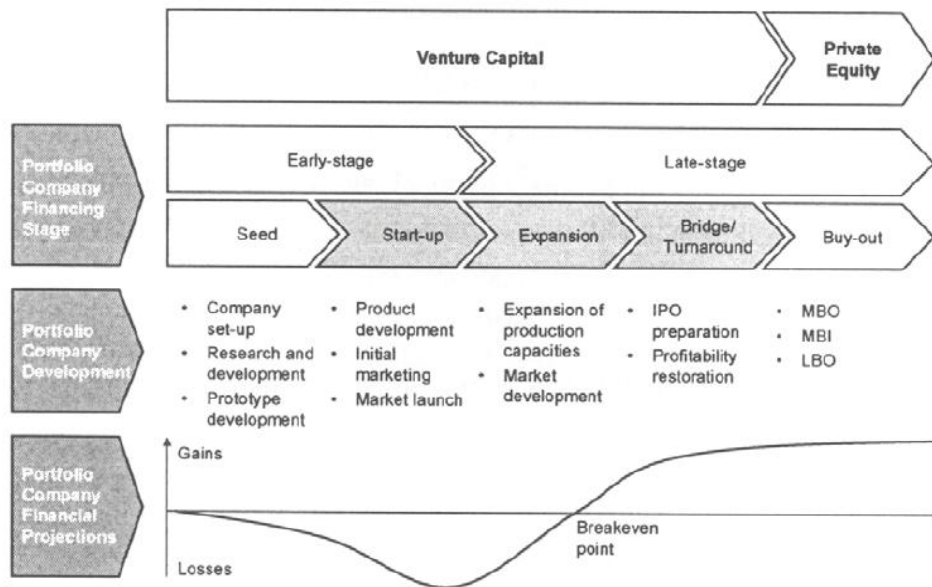
- a) **Seed capital** – aims to finance projects at embryonic stages in which there is a raising idea and the need of research and development prior to the business launch;
- b) **Start-up capital** – designed for supporting the firm's launch and deployment in a market that is usually reflected in marketing or product development.

2.2.2 Later stage

- a) **Replacement capital** – the purpose is to finance the shares' purchase in order to replace a partner.
- b) **Management Buy In** – intended to support the acquisition of a stake in the company's share capital by an external management team.
- c) **Management Buy Out** – aims to support the company's management team to acquire a stake in its capital.

- d) **Turnaround** – the objective is to hold a company's economic and financial restructuring.
- e) **Expansion capital** – intended for companies that are already able to obtain positive results but still need more funding to grow by increasing production capacity and developing new products.
- f) **Bridge capital** – involves funding the initial part of placing the company on the stock market.

Figure 1 – Definitions of Venture Capital and Private Equity



Source: Jung-Senssfelder (2006)

As shown in figure 1, the firms' development stage at which funding is provided is the criteria to distinguish between the concepts of Venture Capital and Private Equity. Venture

Capital refers to investment in companies at the early stage – seed and start-up – and later stage – expansion, bridge and turnaround (Jung-Senssfelder, 2006). In turn, Private Equity is in regards to investment in companies at the buy-out stage (Jung-Senssfelder, 2006).

2.3 Venture Capital process' stages

Prior research provides a variety of theoretical models that attempt to describe the VC investment stages. For example, Tyebjee and Bruno's (1984) model distinguishes five steps in the process: deal origination – finding promising investment opportunities; deal screening – reducing the amount of opportunities and focusing attention just on the more relevant ones; deal evaluation – performing a careful analysis of these investment opportunities; deal structuring - defining the terms of the deal; post-investment activities – all the activities that investors develop to support the investee management and prepare future exit. Shepherd, Ettenson and Crouch (2000) present a model that considers two stages: pre-investment and post-investment. The pre-investment activities include all the tasks until the moment of signing the agreement such as: searching for new investment projects; determining whether new projects meet the investment criteria; performing due diligence; and negotiating the relationship with the entrepreneur. The post-investment activities include all the actions taken by the Venture Capitalist after signing the shareholders' agreement such as: monitoring and supporting management at a variety of fields. Finally, the partnership ends with the Venture Capitalist's exit of the company's capital (Shepherd, Ettenson and Crouch, 2000).

Despite the variety of proposed models, in this research, we will consider three stages of the VC investment process: pre-investment, investment and post-investment.

2.3.1 Pre-Investment

Prior to the investment there are number of steps to consider, which range from the analysis of investment opportunities to the selection of the most relevant ones. Several studies (Correia, 2004; Pereira, 2008; Bottazzi, Da Rin and Hellmann, T., 2008) find that very often the entrepreneurs take the initiative to contact the Venture Capitalist in order to present their project or business. Likewise, Tyebjee and Bruno (1984), based on their study in the U.S. VC industry, argue that in 1980, the vast majority of proposals were made by the entrepreneurs to the Venture Capitalists. As the latter spent little time searching for opportunities, their attitude was rather passive. However, the authors emphasize that there is a changing trend of such an attitude in the VC industry. This is a consequence of the increasing competition between Venture Capitalists, which drives the need to adopt a more proactive attitude in searching for investment opportunities⁶.

Correia (2004) found that 67% of the respondents argue that the first contact between entrepreneurs and Venture Capitalists is made through preexisting informal relationships, consultants, banks and institutions. In the same line of thought, Correia and Armada (2007) assert that the reasons which lead a company to search for VC are: need for equity injection, taking advantage of Venture Capitalist's contacts and recovering or restructuring the company.

Venture Capitalists receive many investment proposals and use different parameters to assess and select those that best fit their profile. Each Venture Capitalist has preferences related to the type of industry, company's development stage, geographic location, and investment size, among others (Tyebjee and Bruno, 1984). In addition, each VC fund has a

⁶ Decree-Law n.º17/1986, 14th June, points out a proactive attitude of the Venture Capital: "the purpose of the Venture Capitalist is the deliberate and systematic search of investment opportunities capable of generating value and providing income to investors, thus justifying the capital invested through the purchase of shares in companies with growth potential and viability".

management regulation⁷ that determines the characteristics of the projects it can invest in (*Anuário APCRI 2008-2009*; Rubin, 2009).

Thus, as mentioned by De Clercq, Fried, Lehtonen and Sapienza (2006), it is essential for the entrepreneurs to be aware of Venture Capitalist's preferences before carrying out the investment proposal. To increase the possibilities of obtaining funding, the entrepreneurs should have a better understanding of the decision making process and also realize how the Venture Capitalist acts after the investment (Shepherd, Ettenson and Crouch, 2000).

Several characteristics tend to be transversal to the Venture Capitalists' appraisal: market potential; strategy's competitive advantage; business plan's quality in terms of marketing, production and finance; attractive expected return; product or service suitability to market needs; exit strategy; management team's excellence, honesty, trust, passion and motivation (Kaplan and Stromberg, 2001; De Clercq, Fried, Lehtonen and Sapienza, 2006; Correia and Armada, 2007; Cumming and Dai, 2011).

Empirical studies, point out that management team is the major feature for analysis, especially with regard to their professional experience (De Clercq, Fried, Lehtonen and Sapienza, 2006; Kollmann and Kuckertz, 2010). Correia (2004) emphasizes the importance of entrepreneurs' and product's characteristics and of having a business plan with realistic forecast. Further studies state that these criteria may differ depending on market conditions, Venture Capitalist's expertise level and investee's activity sector (Champenois, Engel and Heneric, 2006). As the Venture Capitalists' decision-making process consists of several phases, the relative importance of each criterion can vary along the different stages (Correia, 2004). Entrepreneurs should make their project attractive to the Venture Capitalist. In this

⁷ According to Decree-Law n. °319/2002, 28th December, each VCF has a management regulation prepared by the Fund manager which contains the contractual rules governing its operation. The management regulations contain at least the following items: Fund's identification; Fund's manager identification; Identification of the auditor responsible for Fund's legal certification; Fund's duration; Amount of subscribed capital of the VC Fund and number of units; Conditions under which the VC Fund may undertake capital increases and decreases; Investment policy; Indebtedness limits; Income distribution policy; Payback period of investment units, including its initiation and conditions to occur; Terms and conditions of settlement, including early retirement, sharing, dissolution and termination of VC Fund; Other rights and obligations of participants and Fund managers.

sense, Correia (2004) found that, in 83% of the cases, VC managers stated that firms don't have experience in dealing with the process and therefore often rely on other type of experts. Furthermore, 67% of the answers stated consultants being the experts chosen, 50% lawyers and 50% audit firms⁸.

Considering the Venture Capitalist's investment preferences, there is a first analysis known as pre-screening that aims to examine the investment's suitability to the Venture Capitalist's profile (De Clercq, Fried, Lehtonen and Sapienza, 2006). A quick evaluation will take place to determine whether there is a good investment opportunity, since the subsequent stages of analysis require time and effort on both sides. For the same reason, after the pre-screening, it is common to negotiate the partnership's general terms prior to initiating an exhaustive due diligence process. The result of this first negotiation is a document named "term sheet", which establishes the major terms of the potential partnership (De Clercq, Fried, Lehtonen and Sapienza, 2006).

Koryak and Smolarski (2008) define the interview with entrepreneurs as the major source of information. The Venture Capitalist devotes a significant amount of time to be closely acquainted with management team prior to making an investment. The Venture Capitalist aims to analyze what the entrepreneurs want to bring to the market, learn about their skills and goals, as well as how they intend to implement their ideas. Fried and Hisrich (1994) found that the first phase of information gathering, that is part of the decision making process, starts with a meeting with the entrepreneurs. During the evaluation process there are several meetings with the management team to increase the knowledge about the business and to assess the awareness that the entrepreneurs themselves have (Duarte, 2006). Other sources of information can also be used, such as the entrepreneurs' CV and the balance sheet and income statement (Koryak and Smolarski, 2008). Obtaining information by a variety of forms also assumes relevance in collecting information, either through the bank, former partners, and suppliers or customers of the company, among others. Usually, current or potential clients

⁸ The answer options were not mutually exclusive.

are contacted to understand their motivations and its impact on the project's riskiness (Duarte, 2006).

The due diligence process is based on a detailed analysis of the company, including the entrepreneurs, the business market in which the company will enter and the legal constraints. This process has four stages: search for information sources about the project and the entrepreneurs, use of selection criteria, risk analysis and finally drawing up the contract (Faria, 2009). The VC firms try to reduce the risk inherent to decision making by gathering data in an autonomous form for comparison with the business plan presented by entrepreneurs (Duarte, 2006).

The exit scenarios are essential in planning the operation and may even determine whether or not the Venture Capitalist will enter into the firm's capital (Ferreira, 2009).

The firm's development stage will have a major influence on the sources of information used for analysis. For example, if the company is at an advanced stage, there is historical information available, such as accounting data, financial statements and contacts with the bank. If it is a firm in an early stage there is no information available so it is usual to rely on technical studies (Duarte, 2006).

2.3.2 Investment

After the investment decision is made, a contract is prepared - referred to as shareholders' agreement - which aims to regulate the relationship between partners by defining the rights and obligations of each part. The shareholders' agreement seeks to predict a variety of situations in the partnership and is drawn up taking into account the information gathered in the prior stage of analysis. Correia (2004) verified that the main clauses included in the shareholders' agreement (100% of obtained answers) are: starting date; ending date; term conditions; proportion of each shareholders' ownership; voting, dividends and information rights; representation on the Board of Directors; explicit performance measures; reporting frequency and type of information to be provided; exit strategy; and shares

assessment by an expert entity at the time of exit. In turn, Pereira (2008) states that the most frequent terms in contracts are: the obligation of the initial partners to remain in the firm's capital; the Venture Capitalist's presence in the Board of Directors; and the possibility to veto strategic decisions. Correia and Armada (2007) distinguish the main contractual covenants: earn-out covenants; anti-dilution clauses; pre-emptive rights; first refusal rights; non-competition clauses and redemption rights. Cumming (2008) points out a different set of rights that give the Venture Capitalist some control, as: right to drag, force the entrepreneur to sell its shares to a third party and redemption right, which gives the Venture Capitalist the right to sell its position back to the entrepreneur in pre-determined conditions.

The agreement's purpose is to align the entrepreneurs' incentive with the Venture Capitalist's objectives, by distributing the control and cash-flow rights between both (Kaplan and Stromberg, 2001). Kaplan and Stromberg (2004) argue that the rights established in the shareholders' agreement are often contingent on the investee's performance. In general, control, voting and liquidation rights are allocated to the Venture Capitalist if the firm's performance is below of what was expected. If the company performs well, the entrepreneurs obtain more control rights. If the performance is quite good, the Venture Capitalist maintains its cash-flow rights but relinquishes control and liquidation rights (Kaplan and Stromberg, 2004). This contingency of control rights on the bases of performance acts as an incentive to the investee (Tykvová, 2007).

After the partnership begins, the Venture Capitalist becomes active⁹ and committed to the project's success for the reason that its reward depends on it. The Venture Capitalist maintains active involvement at the board level. They are not day-to-day managers but rather provide entrepreneurs the advice and resources they need to achieve sustained growth and realize the full potential of their business. After the entrance into the firm's capital, the

⁹ According to Decree-Law n.º 375/2007, 8th November: "Venture Capitalists and business angels may only have the purpose of developing activities which are necessary for carrying out their main objective, related to their subsidiaries, namely: providing support services to the technical, financial, administrative and sales subsidiaries management, including those for obtaining funding for these companies; undertaking feasibility studies for investment, funding, dividend policy, reorganization, improvement of production processes, introduction of new technologies (...)".

Venture Capitalist is involved in two types of activities: monitoring firm's performance and giving support or adding value (Pratch, 2005; Cumming and MacIntosh, 2001). Performance monitoring reduces potential agency problems in the relationship between the Venture Capitalist and the investee company. Moreover, Venture Capitalist support and value creation are reflected in key decisions for the company's success, counseling, reflecting on the entrepreneurs ideas, and suggesting on a variety of subjects, among others (Pratch, 2005). As Hellmann and Puri (2000) mention, Venture Capitalist can hire professional managers, standardize human resources policies and implement management plans. Correia (2004) adds the support at a **strategic level** – creating and discussing ideas (83%), providing the network of national and international contacts (83%), developing the strategic planning of the business/product/service (67%), enforcing discipline and professionalizing management (67%); complementing the management team and enhancing management skills (67%); **financial support** – supervising financial performance (100%); assisting in financial planning and advice (67%); **operational support** – monitoring budget development (50%), supervising the operational performance (50%). Likewise, Pereira (2008) emphasizes that Venture Capitalist monitors business, inspires management discipline, provides access to contact networks, influences the company's reputation and gives support to the attraction of different forms of funding. Tykvová (2007) contends that through its networks, Venture Capitalist can help the company to find appropriate staff, as well as suppliers, customers and other partners. Additionally, Venture Capitalist offers its experience in management activities, assisting in defining the firm's optimal structure as well as participating in organizational, financial and strategic decisions (Tykvová, 2007). Pratch (2005) points out that Venture Capitalist is usually very active in the search for investors like banks and other Venture Capitalists. De Clercq, Fried, Lehtonen and Sapienza (2006) note that a common characteristic is the pressure that the Venture Capitalist inflicts over the management team to focus on the agreed objectives' achievement. Even though at some moments it may be unpleasant, many entrepreneurs recognize that this discipline is vital for their success (De Clercq, Fried, Lehtonen and Sapienza, 2006).

The Venture Capitalist involvement on the investee management is usually made through a non-executive Director. This can be an efficient way to perform company's monitoring without interference with the operational decisions (APCRI, 2009).

As the VC investment is temporary, there must be an exit or divestment that can be carried out by various ways. There are several features that can influence the exit process, such as the capital market dynamics, state of the economy and relationship between entrepreneurs and Venture Capitalist (Duarte, 2006). The more common types of divestments are:

Trade sale – involves the sale of the shareholding to another company, usually a strategic buyer (competitor in the same industry or similar; supplier or customer who wishes to incorporate the investee's product or technology in its business). This exit can represent a firm's transition to a new owner, if the entrepreneur also sold its entire shareholding – in this case it is an exit by acquisition.

Buy-back – this type of divestment can occur spontaneously or be pre-negotiated at the moment of investment. The more common variants are the buy-back agreements, often through put and call options.

Sale to another Venture Capitalist (secondary buy-out) – this operation is characterized by the shareholding sale to another Venture Capitalist.

IPO (Initial Public Offer) – exit through the opening of the company's capital in the stock market. For this kind of exit to be possible it is necessary to have a developed capital market with good perspectives of liquidity.

Write-off – this operation is held when the Venture Capitalist realizes that the business has no viability by requesting the amount invested in the company and forsaking the partnership. An exit through write-off usually involves the failure of the business.

Correia (2004) observes that more common exit scenarios are buy-back (100% answers) and trade sale (83% answers). Ferreira (2009) concluded that in Portugal the more frequent exit forms are: trade sales, payment of loans and buy-backs, while in other parts of Europe they are trade sales, payment of loans and sale to other Venture Capitalists. Schwienbacher

(2007) examines the fact that IPOs are more expressive in the U.S. and argues that this is due to the existence of a developed capital market.

The moment of exit takes place when the Venture Capitalist's additional contribution, in terms of management know-how, contact networks, among others, is exhausted and do not compensate the costs of maintaining the investment. The Venture Capitalist initiates the divestment process, attempting to identify a partner who can proceed with the project (Duarte, 2006). In this stage, the Venture Capitalist ends its participation in the company, and the level of earnings in the operation reflects the partnership success or failure (Kaplan and Stromberg, 2004).

Das, Jagannathan and Sarin (2003) claim that the high returns required by VC investments are due to the fact that these investments are particularly illiquid. The capital remains invested for a long term with no possibility of being raised – requiring a considerable liquidity premium. In addition, there is a high degree of liquidity risk. This kind of risk is defined as the possibility of the market's inability to provide the best conditions to perform exit, forcing the Venture Capitalist to maintain its position in the company or to sell it at below the fair price (Cumming, Fleming and Schwienbacher, 2003).

2.3.3 Post-Investment

As mentioned, beyond the funding, Venture Capitalist intends to add value to the VC backed firms. In fact, the Venture Capitalist can even do so without investing in the company, as in the selection process the Venture Capitalist raises questions about the business plan and promotes a critical reflection about key factors (Gompers and Lerner, 2001; Helmann, Lindsey and Puri, 2007; Kaplan and Stromberg, 2004). Nevertheless, in this phase, we will focus on the impact of VC after the investment. Correia (2004) notes that companies achieve more discipline, rigor, clearness and professionalism (100%); sustained strategy and planning (83%); network of national and international contacts (67%); institutional credibility and access to partnerships with strategic economic and financial groups (67%); management skills

and enforced management team (67%); increased number and quality of clients, greater business volume and profit (67%); suitability of capital structure, improved economic and financial ratios, financial leverage (67%); effective information systems (67%); and appropriate organizational structure (67%). Correia (2004) further points out that the major contribution of VC is in the following areas: finance and accounting (100%); organization and management (83%); marketing and strategy (50%); information systems and logistic (33%); tax and law (17%). Engel (2002) states that VC increases company's credibility, because it signals the investment quality, thus attracting new investors. Hellmann and Puri (2000) emphasize the increased professionalism of the management team, as well as discipline and rigor, for example, in preparing the financial statements. In addition, these authors argue that the company's marketing strategies also become more aggressive. Gompers and Lerner (2001) draw attention to higher rate of employment and business growth. De Clercq, Fried, Lehtonen and Sapienza (2006) indicate that these contributions enhance company's performance and are reflected by higher revenues and lower costs. Several authors (Schefczyk and Gerpott, 2001; Jain, 2001; Keuschnigg, 2003) note that not all Venture Capitalists add value to the VC backed companies in the same way. Some Venture Capitalists are more active than others and may be focused in certain intervention areas. Moreover, the added value also depends on the investee's specific needs, in particular regarding the type of operations to be performed and the stage of development of the project (Fried and Hisrich, 1994; Smith, 2001).

2.4 The impact of the financial crisis on Venture Capital

The global financial crisis that arose in the past years has had an impact on all economic sectors. Block and Sandner (2009) discuss the impact of the financial crisis on VC in the U.S. technology sector and observed a 20% decrease on the average amount of funds raised per funding round. However, the authors point out that this effect only occurs in later rounds of funding. They argue that the VC backed firms in these conditions need capital to survive and

are more exposed to the financial crisis' negative effects. On the other hand, VC backed firms in early stages of funding may redefine its expansion plans until the market stabilizes. The authors conclude that the financial crisis could lead to a severe financial problem in technology and innovation industries. Block and Sandner (2009) foresee that the financial crisis will impact on VC, mainly for three reasons:

- First, Venture Capitalists can have some difficulties in finding investors. VC investors are typically large insurance companies and banks (Gompers and Lerner, 2001) and these are negatively affected by the financial crisis. In this context, it becomes difficult for Venture Capitalists to raise funds for their new investments and also to meet the obligations with the investments they already had;
- Second, the low activity of the IPO market and the decrease in the shares price creates a serious exit problem. This is a major issue in the U.S., where IPOs are the main exit vehicle;
- Third, the current financial crisis is leading to a long recession and VC backed companies will have difficulty in being profitable, as consumers will have less money to buy their products and services.

Block and Sander (2009) emphasize that there has been no research examining the impact of financial crisis on VC activity so far. Ferreira (2009) states that, given the lack of liquidity in the markets, it is essential to analyze if Venture Capitalists will maintain their shares in the firms for a longer time, until the economic environment recovers and the opportunities for exit become more profitable. In the same line of thought, it is also worth analyzing whether the VC firms will intensify their investment in companies that are in their early stages. The underlying argument is that there are expectations that when the exit time arrives, the crisis would be overcome and the financial environment would be favorable to the achievement of a well succeeded exit (Ferreira, 2009).

A study made by APCRI (2009) asserts that in the current credit and financial crisis, given the trends in VC industry, there are some important challenges for the next years.

Therefore, a change of VC firms' attitude is necessary to increase their portfolios value. In this sense, the following goals should be promoted:

- To ensure a pro-active attitude in the investee companies' management, through an "hands-on" strategy;
- To reduce barriers in terms of organizational culture, promoting a better relationship with the management team;
- To encourage transparency between the Venture Capitalist and the investee companies in order to better monitor the investment projects;
- To increase support for global market challenges, which mean encouraging innovation to defining internationalization strategies for the investee companies;
- To promote the elimination of agency problems.

3. Analytical model and methods

3.1 Research goals

This study was designed to explore the perception that VC managers in Portugal have in relation to their activity. Additionally, we expect to analyze the development of this industry over the past six years by comparing our findings with those obtained by Correia (2004) and explore the impact of the financial crisis on the activity.

In this context, the following are the research objectives:

1. To identify the selection factors that Venture Capitalists consider in the choice of investment projects:
 - 1.1 To determine the Venture Capitalists' criteria, preferences and procedures when analyzing investment proposals;
 - 1.2 To analyze the celerity of Venture Capitalists decision making.

2. To pinpoint the Venture Capitalists intervention forms on the investee companies:
 - 2.1 To analyze the different timings in the VC funding process;
 - 2.2 To study the key terms of the shareholders' agreement;
 - 2.3 To examine the supervision forms and the post-investment activities;
 - 2.4 To perceive the relationship between the Venture Capitalist and the investee company;
 - 2.5 To analyze the divestment process.

3. To identify the Venture Capitalists contribution after divestment to the investee companies:
 - 3.1 To observe the changes resulting from the VC funding;

3.2 To ascertain in which areas the Venture Capitalists provide major contribution to the investee companies.

3.2 Methods

This study investigates VC issues discussed previously on the basis of a qualitative methodology. This methodology is traditionally used in social sciences and allows a deeper understanding of the phenomenon under study (Miles and Huberman, 1994). The inductive qualitative methods can be defined as a variety of interpretative techniques that aim to describe, decode and translate certain social phenomena (Guerra, 2006). These techniques focus mainly on the meaning of the phenomena and not on its frequency. The richness of qualitative research arises from the joint of researcher's effort to understand the meanings and interpretations of study's participants, using a set of theoretical knowledge about the problem studied. The interpretation is made by researcher considering the theories that exist. In this kind of survey there is no hypothesis definition, at least initially. This processes and dynamics analysis does not seek a simple reality description, but an interpretation of the social dynamics (Guerra, 2006). The inductive qualitative methodologies allow constructing a reasoning based on the observed facts, which then leads to general laws, creating knowledge (Guerra, 2006).

Our choice of a qualitative methodology was due to its usefulness to describe the experiences, behaviors, emotions and perceptions of a particular group of people who have an inside knowledge about a certain phenomenon under study (Fernandes and Almeida, 2001; Guerra, 2006). In this research, we intend to investigate and discuss the development of VC activity in Portugal. By analyzing the perceptions of managers with a long experience in the field, we aim to achieve a greater insight into this reality as well as to put forward further explanations for the observed facts.

Qualitative research is suitable for small scale samples selected according to certain criteria. This kind of research focuses on a limited number of participants, thus the issue of representativeness does not arise in a statistical sense. The samples are not probabilistic, as

participants are intentionally chosen for their ability of reporting the perceptions about their lived experiences (Guerra, 2006). In this sense, the sample size is determined by its adequacy to the research goals. It is crucial to ensure the participants diversity and that no exceptional case has been omitted or ignored.

Qualitative research involves data collection method that entails a close contact and interaction between the researcher and the participants. These methods are appropriate for our research goals, as the close contact with VC managers allows us to obtain detailed information and a set of representative examples from the reality under study. Qualitative data analysis may give rise to new concepts and categories, as well as present possibilities for identifying patterns within the data and for developing associations between them.

There are multiple criticisms pointed out to qualitative methodologies, including its “lack of representativeness” and “wild generalization” (Guerra, 2006). Nevertheless, there are two basic and essential concepts that respond to those criticisms such as diversity and saturation. Diversity is related to sample heterogeneity, to ensure consideration of reality variations, through the diversity of participants or situations under study (Guerra, 2006). Having this in mind, our concern was to include in our sample Venture Capitalists with diverse investment profiles in order to obtain different perceptions and achieve an accurate representation of the VC activity in Portugal. In turn, saturation indicates the moment when the researcher must stop collecting data and is able to generalize the findings to the universe. Saturation exists when the data being collected does not bring new or different information to justify an increase in the collection of empirical material. Thus, the sample size can be determined during the research, once there is information saturation when new data does not do more than confirm the previous (Guerra, 2006). Throughout the interviews carried out, we found that information relating to certain issues has been repeated and terminology used by managers is identical. We observed data saturation in some matters, but we cannot overlook the fact that each interview has brought relevant information, especially with regard to examples of situations about Venture Capitalists' day-to-day life.

3.3 Sample

In order to select the sample it is essential to define the population under study. According to the research goals, our target population consists of twenty eight Portuguese VC firms.

Considering our option for a qualitative research approach, we resorted to a non-probabilistic sample type, as it was not randomly constituted, but considers specific characteristics that are relevant for our survey (Guerra, 2006). Before selecting the sample constituents, we conducted an exploratory study about our target population by analyzing all the Portuguese Venture Capitalists' websites. This analysis aimed to identify which Venture Capitalists were suitable to include in our sample.

The sampling type we used is classified, according to Guerra (2006), as multiple cases sampling by homogenization, to the extent that we study several participants of a homogeneous group – Portuguese Venture Capitalists. We searched for diversity within a homogeneous group. It was therefore important to interview individuals with diverse characteristics and to achieve different perspectives on the subject under analysis (Guerra, 2006). Our concern was that our sample included managers from Venture Capitalists with different investment profiles, as can be seen in table 1.

Table 1 - Investment profiles of Venture Capitalists in the sample

Investment in technology and innovation companies.

Investment in healthy companies with leading market position. This Venture Capitalist acquires a stake on the condition to put 100% of the company for sale in the exit moment.

Investment with a Build-up strategy.

Investments with an internationalization strategy or external trade.

Middle market investments, focus on SMEs.

Start-up investments.

Later stage investments, particularly buy-outs.

Another criterion we have considered was geographic location, as Portuguese Venture Capitalists are essentially located in Porto and Lisbon. Thus, we intended to have Venture Capitalists from both regions in our sample, as the context and investment opportunities may vary by location.

The Venture Capitalists' market share has also been a criterion for the sample selection. We focused primarily on companies with larger market share, as we consider important that our sample represents a significant part of the market.

In the first contact with each Venture Capitalist of our sample, we asked for an interview with a manager with long experience and knowledge about the reality of VC in Portugal. The respondents were either members of the executive committee, founding partners, general managers, financial coordinators or investment coordinators. All but one had at least five years of experience in VC activity.

We ended up with a sample of ten Portuguese Venture Capitalists, that represent 35,31% of the market (as reported by CMVM¹⁰).

¹⁰ CMVM is the Portuguese Securities Market regulator.

Table 2 - Firm's characteristics and Participants' biographical data

Panel A: Firms' Characteristics	Nº
<u>Corporate Headquarters</u>	
Porto	3
Lisbon	7
<u>Nº of employees</u>	
<10	6
10-50	4
<u>Nº of investee companies</u>	
<5	3
5-15	4
15-25	2
25-35	1
<u>Nº of VC funds under management</u>	
0-1	2
2-3	6
4	2
Panel B: Participants Biographical Data	
<u>Gender</u>	
Female	4
Male	6
<u>Antiquity in the function (years)</u>	
0-3	1
4-6	4
7-9	3
10-12	2
<u>Academic Education</u>	
Engineering	2
Economy	4
Management	3
Economy and Finance	1

Table 2 presents the sample firms' general characteristics, as well as the interviewees' biographical data.

3.4 Data collection technique

We have chosen to collect data through semi-structured interviews. This is, according to Bertaux (1997), a technique of interest when initiating a field research, as it uncovers the relevant driving lines, given the limited knowledge about the phenomenon being studied. The interview was semi-structured, as we followed the same guide with all the subjects for discussion, but respondents were free to bring to the conversation other topics that they considered relevant and might enrich our study. Despite such flexibility, we sought to keep in mind our research goals along the interviews. We were able to benefit from the flexibility inherent to this methodology, as minor adjustments were made throughout the process of data collection and few details improved on the interview guide. This technique enabled us to gather the respondents' opinions about the reality under study, as well as to explore some issues and obtain precise examples which truly contributed to our understanding of the VC activity.

3.5 Procedures

The study began with a literature review that aims to discuss the state-of-the-art in this field. The interview guide was inspired in Correia's (2004). In this way, the conclusions could be easily compared with those obtained in her previous research. We scheduled a meeting with the author, in IPCA (*Instituto Politécnico do Cávado e do Ave*), where she lectures, to learn more about her research. We took advantage of the opportunity to hear about her contact experience with Venture Capitalists.

Although we made some adjustments, the design of the interview guide was based on the questions raised by Correia (2004). Knowing beforehand her results we reduced the number of topics discussed, removing those that were not emphasized by the author in the study's conclusions¹¹. In addition, we conducted a research on Venture Capitalists' websites, where we found some technical information about VC activity. Based on this information we made an update in terms of language and added some new questions in the interview guide. However, we were careful not to make the interview guide too extensive¹². Our interview guide consists of four parts (Appendix). The first part, entitled "General information", includes questions that allow us to characterize the sample companies. The second part, termed "Identification of selection factors", addresses the criteria and procedures carried out by Venture Capitalist to select investments. The third part, "Intervention forms", intends to characterize the VC activity after investment. Finally, the fourth part, "Impact on the business", tries to assess the partnership's impact on the VC backed companies after divestment.

There is a discussion among authors about whether to go immediately for the ground to register and analyze information or to prepare in advance a theoretical model from which the dimensions of data collection are structured (Guerra, 2006). As opinions are diverse, we decided to follow the recommendation of Guerra (2006) to review the relevant literature on the theme whilst starting data collection. In the present study, we reviewed the literature and examined some documents about VC in Portugal, namely studies made by APCRI, and we constructed a model of analysis. This model consists of concepts, thematic categories and indicators.

When we reached the interview guide's final version, the contacts with the Venture Capitalists were initiated. We had a first telephone contact with each of the twenty eight registered Venture Capitalists in Portugal, in which we expressed our intention of conducting

¹¹ It was necessary to limit the extension of the Interview Guide, otherwise the time to respond might be too long and discourage the VC managers' collaboration.

¹² The interview guide contents the main themes to be discussed in the interview, and is used by the interviewer, without interfere with the interviewee's exposition (Ruquoy, 1997).

this study. In order to present our research objectives, we asked for an e-mail address of someone within the VC firm who can receive our information and give a better response. The e-mail we sent out gave full detailed information on the subject and objectives, guaranteed anonymity and confidentiality and asked for an appointment with a VC manager for conducting an interview. Besides this first contact, others were made that enabled us to make some other decisions we found crucial to achieve our initial goals. For instance, one Venture Capitalist was excluded from the sample based on the fact that the contact person had required us to send the guide before the interview, a procedure that might embarrass the comparability of the interviews among all Venture Capitalists.

Interviews should be conducted in a neutral place and of easy control to the interviewee, because he/she will be more comfortable and able to better manage time when the interview is long (Guerra, 2006). We visited the VC firms and the interviews were performed at a place designated by the respondent. In all the cases, the interviews took place in a meeting room, with a pleasant and neutral environment. Guerra (2006) mentions the possibility of interruptions that can emerge in the interviewee's workplace that may interfere with the interview. In some of our interviews, the only interruptions that have occurred were telephone calls to respondents that were promptly rejected by the subjects. We do not consider that being in their work environment has been detrimental to the interview. Rather, it was an opportunity for us to make an acquaintance with the dynamics of the VC firms we visited.

Before beginning the interview, we asked for permission to voice record it, ensuring confidentiality and explaining that it would merely be used for academic purposes. Eight out of ten Venture Capitalists authorized interview recording. We followed the procedure suggested by Guerra (2006) encouraging writing down notes while the interview is being recorded, particularly about the interviewee's reactions. At the first contact, interview duration time was agreed to be at least thirty minutes. The actual time was variable, averaging forty minutes per interview, depending on whether the interviewee was more or less extended in the answers and his/her willingness in terms of a time schedule.

In an interview situation it is essential to clearly explain the study's purpose, since it helps the establishment of a partnership and a joint reflection between interviewer and

interviewee on the subjects under study (Guerra, 2006). In this case, we started to explain the research objectives.

For data collection to be rich, an honest verbalization by the interviewee is crucial. The lower the interviewer's interference, the more intact will the gathered information be (Guerra, 2006). Thus, our interview guide is divided into major chapters and consists of several "reminder questions" which are only made if the respondent does not mention certain issues in the answers. In general, we found that the issues aroused large interest in respondents, who were quite motivated to convey their insights and give examples of their professional experience. Some of the respondents also offered us firms' presentations in printed PowerPoint slides. In the end of each interview we asked if the respondent would like to further address any topic that was not covered. We also tried to get a critical feedback about the interview itself, this way attempting to find any improvement suggestions that could be considered and readily implemented in the following interviews. Finally, we thanked the collaboration of the Venture Capitalist and promised to send back a summary of the study's main findings as a form of appreciation for the time and help they have granted us. In the following moments, already outside of the interview place, we conducted a brief reflection, taking notes about our perceptions of the interview to ensure the retention of so much information as possible, well beyond what was recorded. This procedure was performed at the end of each interview. Special attention was paid to those two in which we were not authorized to record. In these two cases, additional reflection effort and detailed registration were even more critical. The interviews were conducted between January and March 2011.

Initially, the interviews' recordings were entirely transcribed. In a second stage, we reviewed the recording to verify if it was correctly transcribed and to complete some sentences that were not very clear in the first phase. We were concerned about giving full respect to the interviewees' speech and thus preceded in transcribing it faithfully.

Once transcribed, the interviews were printed, leaving wide margins on the left and right sides of the paper to take notes while reading. As stated by Guerra (2006), in this type of reading it is natural for some subjects and issues to emerge and that these themes should be included in the margins of the interviews' analysis. As the interview was supported by a

conceptual model and a guide, the majority of these issues was identified and may be further completed by those that emerged from the speech (Guerra, 2006).

Based on previous reading, we constructed the interviews' synopses in a vertical grid, with the first column presenting the major themes of the interview guide – the thematic categories. This grid was our conceptual model built earlier throughout the literature review. We started the process of analyzing the transcribed interviews and selecting all the relevant material to our research goals. After this process we started codification, assigning each piece of text or idea to a category of analysis in the conceptual model. Therefore, we obtained a grid of analysis for each interview. We have placed the interviewees' speech itself on the grid, keeping in mind that the same matter can be referred to at different times of the interview. The synopsis aims: to reduce the amount of material to work with; to better identify the body of the interview; to enable the awareness not only of the entire speech but also of its various components; to facilitate the longitudinal comparison of interviews; to have the perception of the interviews' saturation. According to Coffey and Atkinson (1996), codification allows identifying the main topics/phenomena suggested in data, associating examples of interviews that are illustrative of this phenomenon and conducting a comparative analysis of several interviews. Codification is complete when aggregation of the analysis is performed: vertical analysis in which attention is given to each respondent and horizontal analysis that systematically compares the individual analysis for each category.

In the end, we prepared a general analysis grid, with data from all interviews, in which we reduced the information and eliminated repeated ideas. In some cases new categories emerged that we had not considered in the prior conceptual model and we included those categories that seemed relevant to our research goals.

4. Results

The presentation of results is organized on the basis of concepts of pre-investment, investment and post-investment stages. Besides these topics, others new ones also emerged

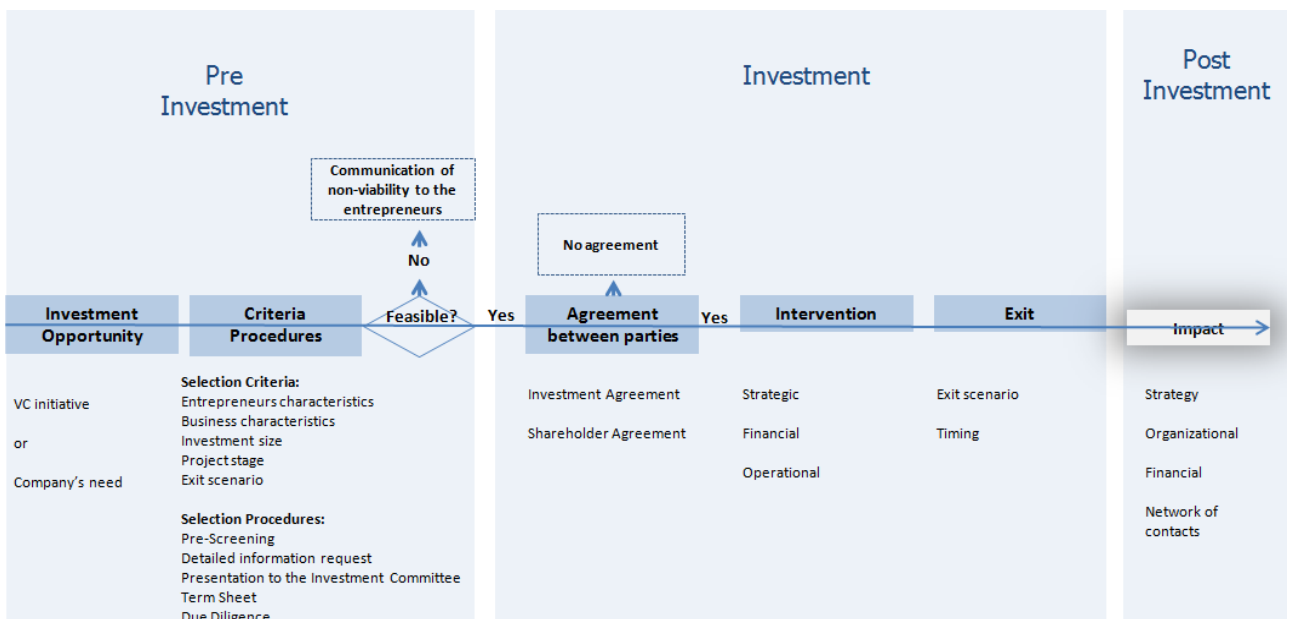
from our data, related to Portuguese firms' experience in dealing with VC and the impact of the financial crisis on VC. We will explore these issues further on this dissertation.

Table 3 – Concepts, Thematic Categories and Analysis Units

CONCEPT	THEMATIC CATEGORY	ANALYSIS UNIT	
Pre-Investment	Investment Opportunity	Venture Capitalist's Initiative/Proactiveness (N=6)	
		Company's need (N=10)	
	Selection Criteria	Entrepreneurs' characteristics (N=9)	
		Business' characteristics (N=10)	
		Investment's size (N=9)	
		Project's Stage (N=10)	
		Exit scenario (N=10)	
	Selection Procedures	Pre-Screening (N=7)	
		Detailed information request (N=5)	
		Presentation to the Investment Committee (N=6)	
Term sheet (N=5)			
Investment	Agreement between the parties	Investment agreement (N=4)	
		Shareholders' agreement (N=10)	
	Intervention	Strategic (N=9)	
		Financial (N=9)	
		Operational (N=9)	
	Exit	Exit scenario (N=10)	
		Timing (N=10)	
	Post-Investment	Impact	Strategic (N=6)
			Organizational (N=10)
			Financial (N=4)
Network of contacts (N=9)			

As can be observed from table 3, all VC managers (N=10) suggest that usually the company's need is the origin of the investment opportunity. There are also six Venture Capitalists in our sample who recognize that, in some situations, they actively pursue the investment opportunity and contact firms with high growth potential. The investments' selection criteria mentioned by all Venture Capitalists were business' characteristics, project's stage of development and exit scenarios. The main selection procedures were pre-screening (N=7) and due diligence (N=8). All Venture Capitalists draw attention to the importance of the shareholders' agreement, which regulates the relationship between partners. Intervention is emphasized by the vast majority of Venture Capitalists as being carried out at a strategic (N=9), financial (N=9) and operational level (N=9). All Venture Capitalists, with no exception, emphasize the relevance of exit scenarios throughout the process. The areas of major VC impact are at the organizational (N=10) and network of contacts level (N=9).

Figure 2 – VC process: Pre-Investment, Investment and Post-Investment



The concepts and categories defined through the conceptual model are represented in figure 2. In this figure, one can observe the three major concepts of pre-investment,

investment and post-investment. We are able to see the different stages of the process that begins with “investment opportunity” and ends with “exit”. Though the “impact” is in the same level of all stages, it is not considered a stage of the process, but a consequence. The lozenge (in the pre-investment stage) represents a decision moment (Yes/No). The explanation below each stage tries to provide some detail about it. In the following section, we specify the data obtained for each concept.

4.1 Pre-Investment

The Pre-Investment concept consists of three thematic categories: investment opportunity; selection criteria; and selection procedures.

Table 4 – The investment opportunity

ANALYSIS UNIT	INDICATOR
Venture Capitalist's Initiative/ Proactiveness	Venture Capital increased broadening Active search for companies that represent good investment opportunities
Company's need	Need for capital injection into the company Need for know-how

The investment opportunity may either be created by the Venture Capitalist - searching for companies with high growth potential to make a partnership proposal - or by the company - that needs support at a variety of fields to develop its projects, as represented in table 4. Tyebjee and Bruno (1984) state that, in 1980, Venture Capitalists spent little time searching for investment opportunities, as they assumed a passive attitude. Nevertheless, this industry is recently being characterized by increasing competition among Venture Capitalists, raising the need for VC firms to be proactive (Shepherd, Ettenson and Crouch, 2000). In Portugal, there have been a growing number of VC operators and proactive approaches are becoming more

and more common (Deloitte, 2006). According to Duarte (2006), in a developed VC market as in U.S., a proactive attitude is vital, reducing the risk of accessing only projects of lower quality which were refused by other Venture Capitalists. We found that the interviewed managers share the same view as Tyebjee and Bruno (1984) with respect to the Venture Capitalists' proactive attitude. The major part of these managers revealed a proactive attitude (N=6) through: approaching consultants and explaining what the VC firm does and what kind of investments it is looking for; market analysis; business' databases analysis; contact with several companies; active search for "healthy" firms that constitute good investment opportunities in order to contact them and make presentations; and promote events that reach some media attention. One of the interviewed managers states that 40% of their opportunities come from an active market analysis and contacts made with the firms. Another manager, from a Venture Capitalist which is directed to start-up projects, emphasizes the dissemination of the VC activity in research centers and universities: *"There is a large promotion in projects support that comes from universities, like spin-off"*. Wrigh, Lockett, Clarysse and Binks (2006) argue that Universities' spin-off face several constraints in obtaining funding and VC can be essential to the development of new firms in new markets.

If the initiative arises from the investee company, we found that the opinion of VC managers is that companies are aware of this source of funding by several ways: other entrepreneurs who have had the experience (N=7); press (N=1); institutional contacts, such as APCRI and CMVM (N=2); banks (N=3); consultants (N=2); and universities (N=1). Although three managers noted that the banks are a major source of VC activity dissemination, there were two who did not agree with this idea, as the banks are directed to debt funding.

The opinion of several VC managers from our sample is that, initially, in Portugal, Venture Capitalists were sought after by firms with financial difficulties. They state that this idea still exists, but has been changing as the investee company is in need of know-how to leverage its development or capital to finance its expansion, or a combination of both. In many cases, the lack of capital is the obvious problem when turning an idea into a realizable project. Nonetheless, an essential problem that usually occurs is the poor managerial

background of the entrepreneur (Tykvoa, 2007). Correia and Armada (2007) argue that the main reasons that lead a company to resort to VC are: need for equity injection in the firm, harnessing the Venture Capitalists' network of contacts and firm's recovery or restructuring. One of the respondents supposed that the investee company does not seek for VC to expand its network of contacts, but it ends up being an added advantage that derives from the partnership. In our investigation, the facts that stand out are the need for capital injection in the firm (N=7) and the know-how that the Venture Capitalist has to offer (N=4). From the perspective of the interviewed managers, there are two core operations of VC: capital increase and capital acquisition. In a capital increase, a new partner enters the shareholder structure, while the others remain. Therefore, the shareholders structure widens and money enters into the company - e.g. product launch, organic growth, internationalization, acquisition of another company. In a capital acquisition, there is a transaction between shareholders. In this case, there is an exchange with no inflow of cash for the company - for instance, if the founder doesn't have guaranteed succession, the Venture Capitalist can come into the capital to help to professionalize management; or if there is a disagreement between partners, one wants to leave and the other is unable to buy, the Venture Capitalist can replace one of the partners. One of the VC managers states that, especially in the current financial crisis, there are firms that seek VC because their projects were rejected by the bank. These projects usually search for VC as the last alternative, when all the other sources of funding fail. The interviewed managers also emphasize other reasons for the VC's demand: *"Entrepreneurs are looking for more than capital, as they recognize they have a limitation in a certain level and they are looking for an entity that can add value in that area in which they are weaker"*; *"We can enter in a situation in which the entrepreneur has reached a certain threshold and he feels that the company needs to take a leap, but he is not willing to or thinks that he is not able to take that leap..., for example, to go to Spain. Therefore, he wants to delegate to someone with greater professionalism to take this step"*; *"We can enter in a situation where we are perceived as a potential to make some money and, at the same time, to encourage the company's growth, or a mixture of both situations"*; *"For example, a start-up has typically two or three entrepreneurs with varied skills, but usually there is a skill missing, it can be*

marketing, financial or network of contacts. That is a circumstance where we can assist and banks have some difficulty”.

Table 5 – The investment selection criteria

ANALYSIS UNIT	INDICATOR
Entrepreneurs' Characteristics	Business awareness/Know-how/Skills
	Honesty
	Experience
	Ambition
	Personal commitment e financial commitment
Business' Characteristics	Technology
	Industry
	Market
	Expected return
	Geographic location
Investment's Size	Investment amount
Project's Stage	Early stage: Seed capital
	Early stage: Start-up
	Later stage: Expansion
	Later stage: Bridge/Turn-around
	Later stage: Buy-out
Exit Scenario	Perspective of term liquidity
	Defined exit scenario

According to Pintado (2002), the investment opportunity's valuation involves multiple stages. There are several empirical studies that aim to analyze the Venture Capitalists' criteria in the investment's selection. Kolmann and Kuckertz (2010) argue that the entrepreneurs' characteristics are of the utmost importance. In table 5, we present the main selection criteria that were mentioned by the VC managers of our sample. In this sense, we found that the vast

majority of managers (N=9) mentioned the management team's characteristics as a criterion they consider when selecting investments. Moreover, some of those managers (N=4) even note this is the most relevant criteria: *"The first characteristic we value in the investment's analysis is clearly people"*; *"We may have projects which are based on excellent ideas, but if we don't have the right people to implement it... it is not worth much. On the other hand, if projects do not have much value, but the team is so good, they may be able to transform that small potential in something huge"*; *"We value intellectual property as a way to maintain competitive advantage and protect our investment"*. Nevertheless, many entrepreneurs may have, or pretend to have, the desirable characteristics. The key factor of analysis should be their professional experience (De Clercq, Fried, Lehtonen and Sapienza, 2006). In this sense, when the interviewed VC managers don't know the entrepreneurs, they try to: find out who they are and what they have done by analyzing their CV (*Curriculum Vitae*); assess whether the team is solid in terms of management skills (if they are a multidisciplinary team, if they have technical, financial or management skills); evaluate if they have a clear vision of the company's future; comprehend if they have relevant financial and personal involvement; and realize if they are honest, resilient, talented and ambitious. Two of the interviewed managers reported that entrepreneurs' failed experiences are highly prized abroad, but not that much in Portugal. These are seen as teaching experiences, because if someone failed in the past, he will possibly not repeat the mistake. VC managers point out that as entrepreneurs will lead the project, the Venture Capitalist should trust them and their abilities to grow the business. De Clercq, Fried, Lehtonen and Sapienza, (2006) add that the entrepreneur's team should be excellent and share the Venture Capitalist's goals. The team should be honest, trustworthy, motivated and passionate about the business. One of the respondents argues that, especially in start-up investments in which there is no historic information about the company, the management team is critical: *"The Venture Capitalist has to believe that the management team will be able to develop the project"*.

All VC managers (N=10) mentioned the business' characteristics as a selection criterion. Characteristics such as technology, business' sector, market, expected return,

geographic location, investment's size, project's stage of development and exit scenario were the most frequently stated.

Half of the managers (N=5) state that their focus is on projects with high technological component and innovation. Innovative products with high growth potential are in the VC's essence (Pintado, 2002; Magalhães, Daudt and Phonlor, 2009). The Venture Capitalist needs to perform gains within a relatively short period – between three and seven years – and a SME with an innovative product has the capacity to grow much faster than a larger company.

The majority of the VC managers (N=7) identify the type of industry as a determinant factor to the investment's selection. One of the Venture Capitalists in our sample focuses its investments in areas that are closely related to the global challenges of the twenty-first century. These are areas such as renewable energy, information systems, health and well-being. Another Venture Capitalist does not intervene in real estate activities, construction and public works, neither activities without any internationalization potential or exclusively intended for the internal market. Other Venture Capitalist admits to be prepared to invest in all business' sectors, with the exception of the real estate and the financial sector. Two of the Venture Capitalists in our sample search for fragmented sectors with consolidation and value creation opportunities. These Venture Capitalists have a focus on ambitious projects of buy-and-built in order to create leading firms in the markets: *“We always have to look to the market where the company operates first and see if we actually can buy that company as an anchor company in the market. Then we go to shopping and buy a number of other companies to form a relevant player. Therefore, we cannot just look to the opportunity that appears to us, but to the entire market in which the firm operates”*. This strategy's priority is the growth through acquisitions in order to maximize integration synergies, economies of scale and brand notoriety.

Aspects related to market position (N=6) are also emphasized as relevant. Some VC managers (N=2) noted that they appreciate the sustainable competitive advantage of their investments: *“We do not believe much in projects that are about doing something that everyone does. In the current globalized market this may not result in a promising business”*; *“A very important point for us is the technology's differentiation towards the market”*; *“We*

must analyze how the company is placed in relation to its counterparts. Which is its differentiation from the competitors?". Tyebjee and Bruno (1984) define product's differentiation as an entrepreneur skill to create a unique and competitive product.

Not surprisingly, expected return has been emphasized by the major part of VC managers (N=6). This return must be attractive, because Venture Capitalists need their businesses for living. In addition, the Venture Capitalist actually shares the risk with the entrepreneur. As VC managers stated *"The key point is the company ability to generate cash-flow systematically"; "To have an interesting profitability it is necessary to invest with attractive conditions, to add value and to sell at the right time for the right price".* If the company does not have sales and results history, the method used is the discounted cash-flow, which discounts the expected cash-flows that the company will generate in the future. The Venture Capitalist shares the total risk with entrepreneurs: *"We have an overall risk position in which we evaluate the company at the time we enter and at the moment we left. This is our profitability. If something has gone wrong, we will also have our part in loss"; "Divesting with capital gains enables us to increase the amount of capital under management in order to support increasingly more projects. For instance, it happens that some of the operations in which we participate are not going well. And this may mean the total loss of the invested capital, depending on the operation. But the other investments that are going well may allow us to have these losses of capital, which are unavoidable, and may generate additional capital to continue our investment process".*

Half of the VC managers (N=5) indicated the geographic location as an investment criterion. We found that the funds' management regulations can determine the investments' geographic location (N=2): *"There are funds that can invest in certain geographies and there are others that can't. Even in Portugal there are certain regions, for which we have no funds. Otherwise, we have funds that cannot invest in certain regions; there are others that are more generalist".* One of the Venture Capitalists in our sample is dedicated to internationalization projects. There is other Venture Capitalist that does not have geographic constraints. Pintado (2002) suggests that firms' geographic location is an important factor in the investment decision. The author adds that there is an inverse relationship between the distances at which

the Venture Capitalist is from the firm and the investment's attractiveness for the Venture Capitalist (Pintado, 2002).

The vast majority of VC managers (N=9) mentioned the investment's size as a criterion. One of the VC managers emphasizes the importance of a balanced financial partnership: *"We don't mind to risk our capital, if we feel that the entrepreneur is also risking his capital because.. let's say.. playing with other people's money is easier. A different scenario is when we can see that the entrepreneur has also a great financial commitment. Therefore, if things go wrong, he will also feel it in his pocket and that is an additional incentive for the entrepreneur to make things go the best way that is possible"*. In the same way, Pintado (2002) argues that the entrepreneur should have a considerable participation in the capital to feel involved with the business. Martí (1995) adds that one of the key elements for a VC backed firm's success is that the entrepreneur risks his own assets along with the Venture Capitalist. In this sense, one of the interviewed VC managers alleged that they always prefer to keep a minority interest in their investments. Other VC manager states that he has both majority and minority interests and looks for positions that give effective capacity for monitoring and intervention – usually above 30%. A different VC manager argues that they have limits of participation, as they do not participate more than 30%.

The Venture Capitalists are typically specialized in investment stages, allowing them to better assess the risk and potential profit (Faria, 2009). There are Venture Capitalists in our sample (N=6) that cannot invest in seed and start-up capital, as the management regulations that govern their funds do not allow it. These Venture Capitalists invest in mature firms that already have results and have proved their ability in the market: *"In the fund's investment policies, which I told you about, the rule is that the companies in order to be invested, must have at least two years of activity"*. Two of the Venture Capitalists in our sample have a fund which is essentially geared towards expansion investments. One of the managers stated that *"Our area of expertise is expansion capital. We like to be at the point where the need for increased funding intersects the reduced business risk"*. Two Venture Capitalists in our sample develop their activity with start-up projects, in very early stages of development. Another VC manager said that they may invest in start-up firms but only if the entrepreneurs

have someone who supports the project in terms of know-how, for instance, a business angel. There are Venture Capitalists in our sample (N=3) with funds specialized in buy-outs in order to replace the shareholder structure, solve succession problems and professionalize management. Pintado (2002) states that there are VC firms or funds specialized in certain stages of development. When these stages of development are over, the Venture Capitalist may sell the investment to other Venture Capitalists specialized in the next stage of development.

The potential of future exit is a key criterion to all the Venture Capitalists in our sample (N=10). The exit is imperative as after a certain period the Venture Capitalist has to divest. As a consequence, before the investment decision is made, the Venture Capitalist has to assess whether the investment is liquid in the market or not. In the funds' management regulation the fund lifespan is set, which is always limited and is usually about ten years. After ten years everything that constitutes the fund has to be converted into cash and has to be repaid to the participants. The Venture Capitalists are concerned in implementing mechanisms that will allow selling their stake in the capital at the time of the exit: *"We invest with the objective of divesting, so we must evaluate the opportunities to leave the investment with valorization"*; *"I cannot invest in a project that may even have a very amused future if then I won't have a way to sell my participation"*; *"The exit mechanism must be defined in advance, because this is imperative, it is not a will, for us and for all Venture Capitalists"*; *"We try to predict and discuss in advance with the entrepreneurs the possibilities and timings for divestment"*; *"Preparing a successful exit is a concern in all stages of the process"*.

One of the VC managers underlines the fact that they have very tight investment criteria that are associated with the funds' management regulation. This manager notes that sometimes interesting opportunities may arise, but which do not fit the fund's profile and, as a consequence, the Venture Capitalist cannot invest. Each VC fund has a management regulation which contains the rules that govern its operation (*Anuário APCRI 2008-2009*).

Table 6 – Investment's Selection Procedures

ANALYSIS UNIT	INDICATOR
Pre-screening	First contact to be acquainted with the business and goals
	Suitability to the funds and Venture Capitalist's profile
Detailed information request	Project presentation in a meeting between Venture Capitalist and entrepreneurs
	Preliminary information: business plan; last report and accounts
Presentation to the Investment Committee	Opportunity VC internal presentation
	Investment Committee Analysis and First Go/No Go decision
	Investment proposal conduction/No investment
Term Sheet	Prior definition of the investment conditions/partnership conditions
Due Diligence	Firms audit - Contracting an external consultant to perform the audit
	Entrepreneurs profile analysis
	Market analysis

In the pre-investment stage, the Venture Capitalists carry out several actions, together with the entrepreneurs, to select the projects in which they will invest. There are multiple intermediate stages of analysis that act as a filter to the numerous proposals that the Venture Capitalist receives. Some of these stages are described on table 6. As one of the interviewed managers refers *“We cannot invest time and money analyzing a project which doesn't meet the basic conditions. We should detect that in the beginning to avoid generating expectations to the other part, and then, for basic reasons we cannot proceed”*. The first contact is the pre-screening which consists of a project's presentation that would enable the Venture Capitalist to ascertain if the opportunity fits the fund's investment policy. In the pre-screening stage, the focus is on whether the firm meets the Venture Capitalist's profile, regarding to industry sector, investment's stage, geographic location and amount of capital needed. As the

following evaluation phases require a large deal of the Venture Capitalist's time, they try to limit the number of investments entering those phases (De Clercq, Fried, Lehtonen and Sapienza, 2006). According to the interviewed managers, this first presentation can occur in a variety of manners, for instance, through the filling of a form that many Venture Capitalists provide on their website. These forms usually contain the fields Venture Capitalists want to learn about the firm and the entrepreneurs. It can also be achieved by sending the Venture Capitalist documents and presentations called "concept papers", "teasers" or "pitch". These documents purpose is to present the idea in two or three slides: explain what entrepreneurs have or what they want to have; how they will accomplish that; what amount of investment they need; which participation they are willing to compromise; if there are other entities or not; and so on. Duarte (2006) reports that proposals sent in a purely formal way are less likely to succeed and may even be ignored. The proposals' personally delivery, including an explanation of the project and its potential, is the industry rule. The existence of an informal mechanism for obtaining entrepreneurs' references in the Venture Capitalist network of contacts is verified (Hochberg, Ljungqvist and Lu, 2007). This mechanism, being a peculiarity of the Portuguese VC market, results from cultural characteristics and industry's size. However, it is also identified by Fried and Hisrich (1994) as an important phase in the projects' evaluation in the U.S. (Duarte, 2006).

Following this first contact, the majority of the VC managers in our sample (N=6) state that the VC firm attempts to present a brief opinion: *"When we receive an investment proposal we are willing to give what we call a "beginning position" in two weeks. In other words, in two weeks we will be able to study the project and realize if it is interesting for us"; "This first analysis we can do in two weeks, so it is very fast"; "When we study a company, we can quickly tell if we are interested or not. I would say that to find out if the company fits, or not, our investment profile it would take us two months"*. Part of the VC managers (N=2) referred that if the project does not fit the investment profile, the Venture Capitalist will inform the entrepreneurs within the shortest time.

If there is a favorable opinion on the project, the Venture Capitalist will proceed to a further study. At this stage, it is usual to arrange a meeting for the entrepreneurs to make a

presentation. Koryak and Smolarski (2008) reported that the most important source of information is the interview with the entrepreneurs. To identify what they want to launch in the market, which are their goals for the project and how they plan to realize their intentions are the more relevant questions to raise. Pintado (2002) adds that at this stage the Venture Capitalist has the opportunity to evaluate aspects such as the entrepreneurs' way of thinking and their ability to respond under pressure.

After this meeting, if there is still interest in the project, the Venture Capitalist asks the entrepreneurs for more detailed information as, for instance, the business plan, the last report and accounts, the historical financial statements and the management team's CV. Pintado (2002) states that the business plan is one of the fundamental tools for making the investment decision. This plan includes all the project details, its current state and future perspectives. Furthermore, the business plan provides full information about the business with regard to fiscal, legal, financial and human resources features. With this information, the Venture Capitalist is able to do an overall analysis and assess the project's potential. In certain occasions the Venture Capitalist may also collaborate with the entrepreneurs in developing the project, as pointed by one of the managers interviewed: *"The business plan is developed together with the firm, to realize what the action plan is, which the strategy is, which the perspectives for development are and what is necessary to get there"*. The timings for this stage always depend on the entrepreneurs' willingness for the meetings and to give answer to the Venture Capitalist's information requests.

If the interest remains, there is a further study considering: sector, distribution channels, main risks, unique value propositions, and exit possibilities, among other features. This study will originate an Info Memo – an information memorandum on the opportunity – which contains a financial chapter with firm's historic information and forecasts. This document usually also includes a chapter that describes the operation's structure. This Info Memo will always have the entrepreneurs' inputs, although it is typically of the Venture Capitalists' authorship. Fried and Hisrich (1994) identified at this stage a substantial increase of time spent by the Venture Capitalist in the proposal analysis. The authors add that the evaluation's purpose is no longer to exclusively determine the investment's potential, but to identify

possible barriers and ways to overcome it (Duarte, 2006). The information provided enables the Venture Capitalist to make the “Go or No Go decision”. These operations internally go through an Investment Committee, “*The management regulations establish that there must be a body that gives its approval*”; “*Basically, the Investment Committee is a brainstorming meeting in which several subjects are discussed, therefore enabling an unbiased view. We may be examining an opportunity that seems very good for us, but we may have not realized some important aspects. Therefore, it is relevant to have other people’s support to identify those features. In fact, there is great interaction between the Investment Committee and our team elements*”; “*The Investment Committee is composed of several people. Each person has plenty experience in a particular area and therefore there are experiences that are more helpful when analyzing a given opportunity and are richer in the contribution they make*”; “*In the Investment Committee the ongoing investments are analyzed and decisions are made. Therefore, there is a forum in which the operations are analyzed and inputs are given. Obviously, during this process there are many interactions with the entrepreneurs, because there are always many questions, as people give us various documents whose readings raise questions that must be clarified*”. From this meeting the “Go or No Go decision” arises. The “No Go” is immediately communicated to the entrepreneurs. If it is a “Go decision”, the Venture Capitalist presents a “Term Sheet” to the entrepreneur that includes the terms under which the Venture Capitalist is available to make that investment: “*It has a number of characteristics but, at the end, it has to collect the entrepreneurs’ agreement to move forward to the next stage which is the due diligence*”. Since the assessment is time-consuming for both parties, it is common to discuss the major deal terms before the Venture Capitalist starts due diligence. The result of the negotiation is the “Term Sheet” which summarizes the major terms of the potential VC investment (De Clercq, Fried, Lehtonen and Sapienza, 2006).

The due diligence aims to confirm the information that was provided by the entrepreneurs. The Venture Capitalist needs to understand if there is any problem in the firm to settle before entering in the capital: “*We require a due diligence to validate the point of departure*”. The due diligence is an analysis made by external consultants and has multiple components: sector dynamics; firm’s strategy; accounts, tax and legal analysis; reports from

prior customers, suppliers and partners; among others. As referred by an interviewed manager: *“Basically the due diligence will give us an additional comfort in relation to what was delivered to us as true... and we believed, in the analysis we made, that was true, than it is just an additional comfort. It is not infallible obviously but it is an additional comfort that we always want to have. This process typically takes 3 or 4 months, never less”*. As referred by Pintado (2002), this does not mean that there is a lack of confidence, but the need to confront the information provided by the entrepreneurs, mainly through the business plan, with its reality.

In summary, Fried and Hisrich (1994) identified the following VC activities as the more common prior to the investment: interview with the project/business managers (100%); visit to the company's facilities (100%); contact with prior partners of the entrepreneurs (96%); contact with current customers (93%); contact with potential customers (90%); examination of the market value of similar firms (86%); contact with product experts (84%); contact with competitors (71%); contact with banks (62%); and request the opinion of other Venture Capitalists (51%) among others.

4.1.1 Firms' experience to handle the Venture Capital process

One category that emerged from the data and we consider important to note is the lack of experience that Portuguese firms exhibit to deal with the VC process. The vast majority of the interviewed managers (N=8) expressed the opinion that entrepreneurs have modest knowledge about VC: *“What I notice is that there are people that contact us and don't know what VC is. And actually they still think this is a bank loan or something accessory to the bank”*; *“I think there is lack of visibility to the advantages of VC and there are still many people who see it as something very tricky”*; *“VC is a relatively recent activity in Portugal and not all the entrepreneurs know the figure of Venture Capitalist. Traditionally, our firms rely more on banks”*; *“Not all the companies have experience and this is even a hindrance, because they are not available to cede much in the decision making process”*. To increase the possibilities of obtaining funding from Venture Capitalists, the entrepreneurs should have a

better understanding of the Venture Capitalist's decision making process and also be aware of the way Venture Capitalists act after the investment (Shepherd, Ettenson and Crouch, 2000).

The interviewed VC managers pointed out that its investments are focused in SMEs with familiar management that normally doesn't know the concept of VC. One of the VC managers of our sample argues this is an area with a very particular language and therefore it is necessary to make an effort to have good communication with entrepreneurs: *"What we try to do internally is to put ourselves in the same level of entrepreneurs to make the conversation flow easier and spend some time to explain things. We try to facilitate the language and communication. Not to bring any new idea without having explained it before"*. This manager emphasizes that if they are not careful the concepts can be misunderstood and entrepreneurs may have the sensation of being misled. The manager added that when the entrepreneurs are advised by consultants, the process is always easier, because there is an intermediary. Another VC manager states that the lack of experience is felt especially in small firms and is noticeable in the business plan presentation: *"When entrepreneurs ask us, we even provide a guide for the business plan, but then the development that is given in terms of the document may be very weak. We are here to help, but this will cause a delay in the operation analysis"*. Differently, another respondent notes that in the recent projects they had analyzed, all the entrepreneurs knew the Venture Capitalist figure. This happens perhaps because this Venture Capitalist operates in areas with new technologies, with young entrepreneurs that may not have had an experience with VC, but know what it is and how it works. To overcome such difficulty, one of the Venture Capitalists in our sample advises the entrepreneurs to contact other subsidiaries to be able to discuss with someone who has had the experience.

4.2 Investment

The Investment concept consists of three thematic categories: agreement between parties; intervention; and exit.

Table 7 - Agreement between parties

ANALYSIS UNIT	INDICATOR
Investment agreement	Common stock
	Preferred stock
	Others
Shareholders' agreement	Entry conditions
	Exit mechanism
	Investment size
	Shares assessment at the time of exit
	Voting and veto rights
	Anti-dilution clauses
	Liquidation rights
	First Refusal
	Put options/Call options
	Lock-up periods
	Representation on the company boards – Board of directors; Audit committee; General assembly
	Board of Directors Matters
	General Assembly Matters
	Explicit performance measures
	Infringement sanctions
	Information that the company must provide on certain dates
	Non-competition rights

Table 7 shows some characteristics of the contracts that are established between the Venture Capitalist and the firm, namely, the investment agreement and the shareholders' agreement. As stated by Fama and Jensen (1983), part of the agency costs arise because contracts are not well written and properly met. Thus, this is an important factor to consider in order to promote the investment's success. Generally, there are two contracts between the Venture Capitalist and the investee: the investment's agreement and the shareholders' agreement. The former regulates the injection of capital or the acquisition of shares, and the latter regulates the relationship between partners. The investment agreement - also named purchase and sale agreement - governs how the Venture Capitalist participates in the firm, which kind of stocks they invest in. In turn, the shareholders' agreement regulates the relationship between partners. The shareholders' agreement aims to predict a number of conditions in the relationship between parties and defines the terms of the corporate governance during the period in which the Venture Capitalist remains as a shareholder. The respondents believe that the shareholders' agreement should be simple and clearly establish the rights and duties of the parties, eliminating potential conflicts of interest. The terms and conditions of the agreement are variable depending on the needs - "*We have a menu of terms with which we play as needed*". However, there are some terms identified as the more common: entry conditions - "*We are available to make a certain operation and we will do it in these conditions and these assumptions*"; reporting that the company is obliged to provide on certain dates - as mentioned by Pintado (2002), the quantity and quality of the information, as well as the frequency of reporting; presence in the Board of Directors and its constitution; Board of Directors matters - "*To define what the entrepreneurs cannot do without our permission (...)in certain clauses, we say that in matter a, b, c, and d, decisions cannot be made without the approval of our administrator. The same happens in the General Assembly*"; "*Generally these are strategic situations, for instance, sale of the company shares, entry into new markets, contraction of funding that exceeds a certain limit*"; "*In everything that could change the company strategy, we must have a word to say*". Pereira (2008) asserts that the obligation of the initial partners to stay, presence on the Board of

Directors and possibility to veto strategic decisions are the most frequent terms in contracts. Our respondents emphasized the mechanisms and timings for the exit: *“The drag-along mechanism can drag the other shareholders to sell. On the other side, with tag-along we are taken with them for the sale”*. There are other very specific mechanisms in VC that aim to ensure that there is an exit without major trouble: *“The investment is more liquid in the market, depending on the availability of capital for sale. 100% is what makes it easier to sell, so I have to define mechanisms on my shareholders' agreement that facilitate this”*; *“Divestment is the heaviest part in our contracts. For us and for the entrepreneurs it is the most important part”*; *“It is important for us to ensure that in ten years we are not in the company's capital, because we can't”*; *“The liquidity matters have to be defined in the shareholders' agreement, because we are a temporary partner and the exit form has to be provided”*; *“There is always a decision that has to be controlled by us and is binding: the exit. In the exit we put 100% of the shares for sale and entrepreneurs are forced to leave the capital with us”*. Respondents also mentioned: rights of non-competition, as the entrepreneurs cannot be dedicated to any parallel project, so there has to be exclusivity; valuation of shares' method – *“The valuation of shares' method may be defined but never its value, because as I said, we are exposed to market risk”*; “lock-up periods” are times (a period of two or three years) when partners are working for the investment's valuation. The investment is capitalizing on its value and only at the end of the “lock-up period” it is possible to sell. The rights established in the agreement are often contingent on measures of financial and non-financial performance. If the investee firm performs poorly, the Venture Capitalist obtains full control. As performance improves, the entrepreneur obtains more control rights. If the performance is outstanding, the Venture Capitalists retain cash flow rights, but surrender the major part of their control and liquidation rights (Kaplan and Stromberg, 2004; Winton and Yerramilli, 2008).

One of the interviewed managers warns about the fact that there are exceptional circumstances that may be considered in the shareholders' agreement, for instance: *“Let's consider that an operation, by any urgency, has to move faster and then we can eventually close the deal, before validate the starting position. In that case, there would be a resolute*

condition in the shareholders' agreement if there were significant deviations from expected". In the same line, Pintado (2002) suggests that the contract may be define that if there are omissions, the cost of those cannot exceed a certain margin. The author further states that there should be a time limit for the Venture Capitalist to complain for any errors or omissions and that period can be between six months to a year. Pintado (2002) notes that it is essential to establish in the agreement a number of safeguard clauses for the investor, in order to ensure that the investee will work for the project's success, as well as to provide the Venture Capitalist with mechanisms to correct possible deviations.

Table 8 - Intervention

ANALYSIS UNIT	INDICATOR
Strategic	Strategic planning
	Generate and discuss ideas
	Approach new business areas
	Strategic alliances
	Expand network of contacts
	Recruiting and selection
	Salary policy
Financial	Planning/Counseling
	Supervision of performance
Operational	Planning/Counseling
	Supervision of performance

Table 8 exhibits the areas in which the Venture Capitalist intervenes during the partnership. Nine of the interviewed managers point out that they have an active intervention – “hands-on” - in the investee company during the partnership. Just one of the firms in our sample claims not to be active in the intervention, but intends to begin to participate actively

in the near future. Some of the Venture Capitalists (N=4) have a non-executive Director in the investee companies which intervenes according to the firm's needs: *“Our intervention can be necessary and we respond or it may not be required and we do not intervene, therefore, only insofar as we add value”*; *“Our monitoring is very close to the entrepreneurs' team, very close to the project, but we do not require to have executive members in the Board of Directors. The follow up involves all areas in which we can add value and in that the entrepreneurs' team does not have many skills”*; *“We have an area formed by the colleagues who do the monitoring of all our investments. We are geographically divided and we have non-executive members in all the companies that we participate”*; *“We have, at least, a monthly meeting with our subsidiaries, we usually talk, if not daily, every week. We receive the management information that is defined in the shareholders' agreement in order to do monitoring and to intervene in the sense of value creation. In every investment projects in which we have analyzing and structuring experience, we actively participate”*; *“There may be a subsidiary that needs daily attention, whilst another just needs monthly care. And that is not a constant; there are more intensive phases than others. Our intervention is tailored to the firm's needs, this means going one morning or one afternoon a week to work with entrepreneurs if it is necessary... And this working together can be many things, in the commercial, strategy and financial area, among others”*; *“We talk very often with the General Directors, the Financial Directors, with the main figures of the company, but we don't make any day-to-day business' decisions”*. The involvement of Venture Capitalist in the subsidiaries' management is usually guided by a non-executive representative on their Boards of Directors. This is an efficient way to carry out monitoring, but without undue interference in the operational decisions (Estudo APCRI, 2009). According to data from interviews, we found that generally the Venture Capitalist's representative is present in the monthly Board of Directors meeting, in which a summary of the last month, as well as the establishment of the goals and objectives for the next month, are made.

As De Clercq, Fried, Lehtonen and Sapienza (2006) state, the Venture Capitalist is essentially engaged in two types of activities: monitoring and providing value added. The monitoring reduces agency risks in the relationship. The interviewed managers reported that

their intervention: *“Is in a perspective of suggesting, because it is not our firm, nor are we going to manage it, thus we just give the necessary support”*; *“The management team has a number of characteristics in which we trust and we think they have the right skills to implement the developed business plan. Our intervention is not only active to monitor the company's development and support important decisions, but also to help and facilitate in whatever way possible the society development”*. The interviewed managers emphasize the fact that they have shares in companies operating in different sectors, which helps them to have more visibility of some companies' best practices that can be applied in the others. It is also important for the Venture Capitalists of the sample to perform a follow up in order to verify whether the activity is consistent with what was outlined in the business plan.

One of the managers that constitute our sample refers that the intervention's impact depends largely on the size of the investee. In small companies, the Venture Capitalist's intervention is not only more active at the strategic level, but also in some operational aspects. In large companies, the intervention is limited to monitoring, attendance at Board of Directors' meetings to learn about the business, but without adding anything in terms of management. Between these extreme examples lie the intermediate cases that constitute the majority of the investee companies. One of the respondents stated that he/she continually revisits each investee company and its market in order to identify potential changes in trends and areas of poor performance. In this sense, the Venture Capitalist supports management teams in the realignment of strategic investment goals. Another VC manager states the cooperation in the strategic lines' formulation and implementation. The manager also mentions the support in the business plan construction and revision. One of the VC managers notes that the decisions taken together are those that are more relevant, which may change the company's strategy.

One of the respondents states that due to their investments' characteristics - start-up companies - there is a strong interaction in the strategy's definition and a very close involvement. The manager notes that it is always important to share experiences and listen to advice from more experienced people. This manager adds that this is the Venture Capitalist's role and it is much appreciated by entrepreneurs. Another manager stated that the Venture

Capitalist's role is to bring issues into discussion and solutions that are from other subsidiaries. Shepherd, Ettenson and Crouch (2000) note that Venture Capitalists act as sounding board for management ideas and give strategic and operational advice. Rather than making decisions for the entrepreneur, Venture Capitalist aims to provide advice and encourage reflection on the ideas (De Clercq, Fried, Lehtonen and Sapienza, 2006).

We found that to encourage the expansion of investees' network of contacts, Venture Capitalists take various initiatives: *"We have a custom here to provide events, not only to get close to our investee, but also to make all managers of our subsidiaries to meet and exchange experiences. These investments are very specific and have the same difficulties. The exchange of experiences is very important because there is always someone who's been through it"*; *"We have a strong partnership with other Venture Capitalists globally, increasing the flow of attractive investment opportunities, attracting foreign investment for Portuguese companies and opening doors for all our subsidiaries"*; *"We try to open doors, to create contacts, to help in attracting customers, all that is within our reach"*; *"We provide access to our network of contacts. Some of our investee companies want to internationalize to Angola or Brazil, and we have teams there, so we help companies to get there faster and we make the bridge with other companies, even our subsidiaries, that can exploit the market together"*.

In our sample, some Venture Capitalists have a particular strategy of buy-and-built (N = 2). For instance, one of these Venture Capitalists searches for an anchor company in a certain market and then buys some other counterparts to form a relevant player: *"We have to put it together, we have to assemble the management team, we hire the CEO, the CFO"*.

One of the respondents states that the Venture Capitalist implements stringent mechanisms to ensure the business plan achievement. The Venture Capitalist recurrently monitors the performance of its portfolio companies, focusing on the financial results and budget execution. Another Venture Capitalist emphasizes the capital structure strengthening for the development of growth strategies, as innovation, internationalization and structuring of corporate finance operations. Venture Capitalists in our sample stand out in their financial intervention aimed to optimizing the financial structure, adapting it to strategic objectives. One of the Venture Capitalists mentions that they work closely with the investees' finance

team, because they are associated with a bank. Besides being easier to follow, they also require and help the company to have some information standards. However, the manager notes: *“But we are not going there to do everything, we just work cooperatively with the team”*.

In operational terms, one manager says that the Venture Capitalist ensures the existence of a professional view on the operational efficiency. The VC team often leads the implementation of modern ERP (Enterprise Resource Planning) tools and information systems, facilities' modernization and renegotiation with suppliers of the major cost items, among other initiatives. Other Venture Capitalist in our sample emphasize the capital structure's optimization, workflow's rationalization, cash flow's management, cost reduction, assistance in setting up reporting systems and management control. Once more, there is a focus on sharing experiences: *“Improvement of operating practices through sharing experience and know-how accumulated by our staff and the management teams of our portfolio companies”*. According to Pintado's (2002) opinion the Venture Capitalist's intervention is a process that adds value and that goes beyond funding. We emphasize the assertion of an interviewed Venture Capitalist that does not interfere in investees' operational decisions: *“If the company wants to hire a Sales Manager... I do not even care who he is, because the company has to be responsible for the good and bad decisions”*. The Venture Capitalist only intervenes in strategic decisions, *“Obviously, if the company that sales sandwich wants to go into the salads or soups market, we will have a word to say. But if this company wants to sell strawberry juice instead of orange juice, we have nothing to do with it”*. Another Venture Capitalist shares the same attitude: *“In the strategic decisions we clearly intervene. In operating, it depends. In current issues of day-to-day, not necessarily, unless we are asked for opinion in any special area. Then, there is monitoring to verify whether the activity is consistent with what was outlined in the business plan or not”*. The manager adds that the Venture Capitalist always has information about the company's current operations, but does not influence it.

Table 9 - Exit

ANALYSIS UNIT	INDICATOR
Exit Scenario	Buy-back
	Trade Sales
	Sale to another Venture Capitalist
	IPO
	Write-off
Timing	Exit within the deadline
	Exit before the deadline
	Exit after the deadline

Table 9 exposes the main exit scenarios and the moment when it usually occurs. Pintado (2002) states that exit happen to be one of the most delicate operations of the entire investment process. The VC firms, as a temporary partner, have to accomplish divestment after a certain period of time. This stage is so important to the point that the decision to invest in a company is largely influenced by the ease of exit and the potential profitability (Kaplan and Stromberg, 2004). As mentioned earlier, preparing a successful exit is a concern among all VC process' stages. It is essential to define a clear exit strategy that allows the maximization of returns to shareholders and management team. Beyond the imperative need to divest, the Venture Capitalist is exposed to a high liquidity risk (Kaplan and Stromberg, 2004; Ferrary, 2009).

The exit may occur by the approach of entities interested in buying the share or through a sale process structured by the Venture Capitalist: *“We make a blind profile with a presentation of the company, we send it to a contact list and, if someone is interested, may submit a proposal”*; *“When we are closer to the fund maturity, when we cannot keep those shares and we have to make it liquid, what we have is an irrevocable date for sale, this means*

we should hire an entity that makes an evaluation of the company, so we can sell our shares. The entrepreneurs can buy it or indicate a third buyer. Otherwise, we are free to go to the market to find someone to buy our shares”.

The exit can occur in several forms: buyback - usually the Venture Capitalist makes an offer to the management team for a given value and the entrepreneurs have the option to buy the share. One of the VC managers claims that this is the more common form of exit, while pinpointing some problems that can emerge: *“If not 100%, in 99% of shareholders' agreements that is the main exit form. I will not hide from you that sometimes it happens that we arrive at this point, especially when something goes wrong, and the entrepreneurs do not want or cannot... do not have the conditions to meet the obligations. We can even get into a litigation process with the entrepreneurs... we have some of these situations”.* Some Venture Capitalists (N=4) argue that trade sale is the more common exit scenario. It consists of selling to another entity: *“Sometimes these are entities that do not want to take the trouble of consolidation, which is more complicated. Then they prefer to take a player that is already composed with professional management. They prefer to wait for us to do this job”;* *“When we sell the company, we put 100% of the shares for sale and they are forced to leave with us. We put up for sale 100%, then it may happen that the buyer also wants to stay with the management and the management can come to reinvest later... it may happen, but we need to have the possibility of the sale by 100%”.* One of the respondents refers the sale to a financial partner or to another Venture Capitalist as an exit possibility. All Venture Capitalists recognize the difficulty of the exit by IPO (Initial Public Offer) to be feasible given the characteristics of the capital market in Portugal. All consider that this could be the most interesting exit form, but in Portugal it is very difficult because companies do not have dimension and the market is not very dynamic. Only one of the Venture Capitalists has held out for an IPO since it acts internationally.

According to APCRI report (2008-2009), trade sale was the exit form which moved higher volume of capital. The second and third exit forms with major importance for divestment were, respectively, the sale management (management buy-out) and exit via silent partnerships – a business partner who provides capital but does not actively participate in the

management of operations. The exit strategies used by most Venture Capitalists was the buy-back.

The interviewed managers converge when they consider that the time for exit is when the investment's objective is fulfilled: *“We invest with a particular purpose and this goal takes 2, 3 or 4 years to be implemented and therefore we think it makes no sense to be out before that. But it has happened to be a sufficiently interesting proposal in which the parties agreed to leave after one year. The normal time period is always after 3 or 4 years, but it may be before”*; *“We do not have a defined time to exit, normally we assess the project and if we determine that in x years it is able to grow, it is able to be sold and we say that it is from this year that we can make an offer to entrepreneurs”*; *“When there is a good opportunity, when the growth cycle is completed, we will try to release the process, but sometimes is not easy to find buyers for our assets. If we think that we're not in the right cycle for divestment, if we can, that is if the fund still has a life that allows us, we'll still stay in the capital beyond the time we had imagined to stay”*; *“We have set an exit target. That is, we know how long on average the investment lasts, or how long it should last, it is normally between 4 and 6 years. This does not mean that it will happen as planned. We do not say that we have to leave in five years, this does not happen. We know more or less it will happen, but it depends on the opportunity, depends on what has been done in the company, depends on whether the goals had already been accomplished or not”*.

4.3 – Post-Investment

The Post-Investment concept consists of one thematic category: impact.

Table 10 – Impact

ANALYSIS UNIT	INDICATOR
Strategic	Planning
Organizational	Professionalization
	Reporting
	Forecast
	Discipline; Rigor
Network of contacts	Managers of all subsidiaries
	Financial Institutions
	Law Firms
	Head-hunters
	Marketing and communication firms
	National/international contacts
Financial	Budget
	Forecasting
	Increased business volume
	Funds to leverage equity
	Suitability of capital structure

In table 10 are presented the main areas in which VC has impact. Several interviewed VC managers note that, in general, the management of its subsidiaries was familiar and

became professional after the intervention: *“The company has an executive committee, whilst formerly it only had the boss, the company’s shareholder”*. The professionalization of the management results into more discipline, accuracy, enhanced management skills, balanced management team, clear management rules and defined reporting. In this sense, one of the VC managers emphasizes *“We have to look at what the benchmarks are and make the company to be as professional as possible, which means to have a reporting and information systems capable of providing answers that allow making important decisions”*. One of the VC managers adds *“I would say that the major difference is the management with much more care in financial analysis of investments. To have tools that allow learning, at least ex post, whether a purchase was good or bad; that enables us to understand why it was bad and why it was good. I will give you the example of a company in which we entered: they would buy a machine, because it was interesting to have the newer machine in the market to rent, whether or not there was a market for renting this machine. What we imposed was to think whether or not there was a market for renting the machine before making the investment”*. The interviewed VC managers share the idea that it is important to make this effort, to have the necessary information and obtain the maximum value for the company.

The respondents believe that by defining a methodology, the entrepreneurs achieve organization and a certain discipline: *“When there is a financial partner that comes from outside, it requires that there are certain rules and a formal decision-making and this is quite important”*. Another VC manager said that they aim to create an urgent sense of decisions: *“The actions must have an impact within a pre-defined term and there are timings to be respected. We shouldn’t say “one day we will contact customer X”, but we must define when we will contact the customer X”*.

One of the respondents stated that strategy is one of the major contribution areas: *“The strategy become more sustainable because every strategic decision is obligated to pass by the Board of Directors and must be sustained. We contribute to the reflection of where the company should go... to think about what decisions will help to improve the company”*.

The VC firms in our sample share their network of contacts with the subsidiaries, for instance, by promoting events for all the managers to meet and exchange experiences;

providing contacts with financial institutions, lawyers' corporations, head-hunters, corporate of marketing and communication; and contacts with other VC operators. As stated by Shepherd, Armstrong and Lévesque (2005), one of the major benefits of the VC partnership is the access to the Venture Capitalist's extensive network of contacts.

One of the respondents points out that those investees whose operations went successfully gained major relevance in economic terms and resilience to the downturn. These companies have catalyzed knowledge, created skilled jobs, attracted wealth through exports and attracted foreign investment. As mentioned, the companies also acquire major sensitivity to discipline on financial features.

One of the respondents, from a Venture Capitalist which is exclusively dedicated to start-up projects, emphasizes the deep transformations that are notorious after the investment: *"Both the companies' operations as the financial side, the direction which plans the strategic vision... everything grows while we are there, everything is built. We are talking about something completely different, surely a completely different business with another vision and another structure... and also a different market position, we hope. Usually the business itself turns around. Even the business plan becomes quite different from the original project. At the business level there are changes quite clear, which is a good signal"*.

We consider interesting to note the opinion of one of the VC managers regarding to what was defined in the business plan and what is realized: *"I have never seen a business plan that was overcome. Entrepreneurs always say that the business plan is conservative. We introduce, in our analysis, even more conservativeness and often reality turns out to be worse than all of this. As a rule, it does not happen that reality overcomes what was presented to us in the business plan. Now, this makes us conclude that it hasn't been successful? No, I mean, there was a perspective that had not been confirmed, yet the company's evolution can be clearly positive"*.

4.4 Impact of the financial crisis on Venture Capital

Table 11 – Impact of the financial crisis on VC activity

	Countercyclical
	VC has access to more interesting projects/companies
Impact of financial crisis on VC	Crisis impact on investee companies
	Companies' and projects' assessment
	Difficulty in raising funds
	Difficulty in structuring operations that require some debt

Block and Sandner (2009) state that until now there is no research analyzing the impact of the financial crisis on VC activity. As regards to this impact the respondents' opinions are diverse. One of the managers argues that their portfolio reflects the reverse of what is happening in the economy right now: *“I think that it has much to do with the ability we have of helping firms to recover and our know-how. Even in difficult times, when working on top-line – sales – of companies can be tricky, there is much work that can be done in the bottom-line – costs and synergies of integration. Therefore, there is much work to do not to lose the value of the company”*. The manager notes the fact that some companies may feel the crisis' effects in the top-line of sales, but that does not have a negative impact in the companies' valuation. Therefore, this manager's perception is that their portfolio is countercyclical.

Table 11 considers the perceptions that the VC managers have about the impact that the financial crisis has had on VC. Some respondents (N = 3) point out the impact of the financial crisis in VC as very positive for several reasons. First of all, there are interesting projects that would be unlikely to resort to VC, if they were not going through a phase of financial crisis. In this context, bank credit is increasingly difficult to obtain and even more expensive. In the same line, there are companies that in a situation of no crisis would not feel the need of searching for a Venture Capitalist: *“Right now what I feel is not so much the higher number of*

contacts, but the quality of contacts that is slightly different. We have less new venture contacts and more contacts of companies that we all know in our day-to-day, considering the possibility of making venture capital operations, precisely because they are in a difficult situation". Besides, the respondents argue that there are entrepreneurs who lost work or saw their conditions worsened, and take the risk that is often avoided when people are comfortable. Otherwise, they may have a great business idea that would require a 100% dedication, but for fear that something might go wrong, people do not take the risk. This crisis can act as an encouragement for these good opportunities to arise.

Nevertheless, the interviewed managers (N=4) also recognize that major part of its subsidiaries has been, or still is, suffering from crisis. This is particularly felt in the reduction of business volume and even in the loss of profitability that also generates a major Venture Capitalist's involvement. Companies that are supported in the local market and do not have a clear competitive advantage have more difficulty. One of the respondents stated that all companies which are dependent on private consumption are being widely affected. Obviously, the Venture Capitalists must perform periodic assessments of their portfolio and those companies which are affected in sales and profitability also affect the Venture Capitalist, because these will be devalued. Therefore, this conjuncture has a direct impact on devaluing the Venture Capitalist's equity. Another of the interviewed VC managers is looking on the bright side of the crisis: *"I think this is an opportunity for companies which can survive from a recession like the one we live now, there are two hypotheses that I think we should value: companies are benefiting from the downgrade or trading down of consumers... and if we believe that trading down is coming to stay then we should invest in those companies. And the second is that if a company has the ability to react in those moments of recession and market decline, this company will surely emerge stronger at a time of market expansion. These companies that have a less bad performance than others have to be very carefully analyzed"*.

The VC managers in our sample emphasize that the financial crisis has an impact in the evaluation of investment projects. When analyzing a project, the Venture Capitalist always considers the perspective of the binomial risk-return: *"The crisis impact occurs more in the evaluation of specific companies or certain projects. We have to find if, in the current*

environment, that product, service or technology makes sense or does not, for market reasons. If it does not make sense now, tomorrow it might make sense". Another issue raised within a crisis context is the uncertainty in consumer behavior: *"I am a lot more careful now when I look at a company, because I do not know if what occurred in 2009 and 2010 will occur in 2011, nor am I able to predict what will be the company's and consumers' behavior. And when something negative happens we also do not realize why, if it has to do with the company, or if it has to do with the markets, ... "*. The major difficulty in the analysis is the realization of the timing of recovery. Therefore, this makes the analysis of the opportunities difficult and the VC investors become more careful, selective and probably take longer to analyze and decide. Also the entrepreneurs, who generally have an expectation of very high value for their business, become less confident. Thus, they are more receptive not only of VC, but also in making operations under more suitable conditions.

One of the negative aspects that the crisis brings to the VC is the difficulty in attracting investors, which also makes it very hard to raise funds. As the investors in VC funds are generally large investors, like insurance companies and banks (Gompers and Lerner, 2001), which have been negatively affected by the financial crisis, Venture Capitalists will come across considerable difficulties in finding investors.

Two of the interviewed managers argue that this situation will hamper the structuring of transactions that require some debt, because there are many operations that are made with equity and debt. This happens not only to structure operations, but also in various situations of the companies' life. Therefore, the lack of credit really punishes the companies.

5. Discussion of results

In this section we aim to compare our findings with those obtained by Correia (2004). Thus, we considered the main topics under study to be: broadening of VC in Portugal; companies' awareness of VC; reasons for VC funding search; investment selection factors; timing of decision making; shareholders' agreement; intervention; exit; and impact after divestment. For purposes of comparison, we converted the obtained answers into percentage form, to match that of Correia's (2004) results.

5.1 Venture Capital broadening in Portugal

Table 12 – Venture Capital broadening in Portugal

	Correia (2004)	Current Study
Good	33%	50%
Weak	67%	40%
Null	0%	10%

The managers in our sample expressed quite different opinions about the broadening of VC in Portugal: the majority indicates that it is “Good”; though, there is a significant part that classifies it as “Weak”, as shown in table 12. In Correia's (2004) survey, the vast majority of the subjects rated it as “Weak” and only a minor part stated it as “Good”. Therefore, there seems to be a positive trend in the VC managers' perception about the activity broadening in Portugal between 2004 and nowadays.

5.2 Companies' awareness of Venture Capital

Table 13 – Means by which the companies become aware of VC

	Correia (2004)	Current Study
Informally	67%	70%
Bank	67%	30%
Institutional Contacts	67%	20%

We found that, in most cases, companies become aware of VC informally through experiences' exchange with other entrepreneurs who have had contact with VC, as represented on table 13. In the current study, managers also referred to the VC marketing (20%) and the press (10%) as sources of information. Correia (2004) found that VC awareness was accomplished through: pre-existing personal relations, informal contacts, external consultants, bank and institutional contacts (67%). We verified that results of both studies are similar, although Correia (2004) registered higher values for the bank and institutional contacts and there was no references to VC marketing and press. In both studies, informal relationships were a prime source of information by sharing and exchanging experiences with other entrepreneurs.

5.3 Reasons for Venture Capital funding search

In our study the main reasons for VC searching were the need for equity injection in the company (70%) and know-how (40%). There were managers who reported both reasons. In Correia's (2004) survey the need for capital was also the major reason (80%) and there were other more specific reasons that may be associated with the need of know-how, for instance, "approach to new business areas". It can be seen that, in both studies, there was a need of equity injection in companies. In our study, the increase of contacts network has not been identified as a reason for VC searching, as noted in Correia's (2004) research, but as a partnership's positive consequence.

5.4 Investment selection factors

Table 14 – Selection factors

	Correia (2004)	Current Study
Entrepreneurs' characteristics	100%	90%
Project's characteristics	100%	100%
Exit scenario	83%	100%
Investment's size	67%	90%
Project's stage	67%	100%

Through table 14, one can argue that, in our study, the major criteria and preferences for selecting investments were the entrepreneurs' characteristics, projects' characteristics, exit scenario, investment's size and project's stage. In Correia's (2004) study, the most important criteria were also entrepreneurs' and projects' characteristics. The mentioned criteria were similar in both studies, with only minor differences between them. In Correia (2004) the relevance of the entrepreneurs' characteristics, which was mentioned as a relevant criterion for all participants, was even more significant. Nevertheless, in our study there were several VC managers who also claimed that it was the most important criterion in the investment's analysis. The investment's size, project's stage and exit scenario were more frequently referred to in the current study than in the study conducted by Correia (2004).

5.5 Timing of the decision making process

Table 15 – Timings of the decision making process

	Correia (2004)	Current Study
<2 months	50%	50%
2 a 4 months	33%	30%
4 a 6 months	17%	20%

Regarding the timing between the beginning of the process and the Venture Capitalist's decision making, we found that most participants state it to be less than 2 months. This is similar to Correia's (2004) findings (table 15). The results of either study demonstrate a Venture Capitalist's concern to take an expeditious decision, although there are factors that can delay the process and do not only depend on the Venture Capitalist, but also on the management team.

5.6 Shareholder's Agreement

Once the decision is made, the shareholders' agreement is held to regulate the relationship between partners. Our study's participants reported that the main clauses of the shareholders' agreement are: exit mechanisms; Board of Directors and General Assembly matters; presence on the Board of Directors; information reporting; rights of non-competition; and shares valuation's method at the exit time. In Correia (2004)'s survey, participants mentioned the main parts of shareholders' agreement to be: exit mechanisms, presence on the Board, information reporting and rights of non-competition. Matters of the Board of Directors and General Assembly were not mentioned in Correia (2004)'s study.

5.7 Intervention

Table 16 – Areas of intervention

	Correia (2004)	Current Study
Financial planning	67%	80%
Financial supervision	100%	70%
Operational planning	50%	70%
Operational supervision	50%	70%
Strategic planning	67%	60%
Generate and discuss ideas	83%	50%
Strategic alliances	50%	50%
Salary policies	50%	30%

The Venture Capitalist activities after investment mentioned by the majority of respondents in our study were: financial planning, financial supervision, operational planning, operational supervision, strategic planning, generate and discuss ideas and strategic alliances. In Correia's (2004) study, the results were similar, with minor differences: financial supervision more expressive than financial planning; in our study, there was major emphasis on financial planning (table 16). The activity of "generate and discuss ideas" was also more noticeable in Correia's (2004) study than in the present one. The operational planning and supervisions were prominent in the present study as well.

5.8 Exit

Table 17 – Exit mechanism

	Correia (2004)	Current Study
Trade Sale	83%	80%
Buy-Back	100%	50%
Sale to another Venture Capitalist	0%	10%

The more frequently mentioned exit forms in the current study were trade sales and buy-back. Correia's (2004) had similar findings, though the buy-back had a much higher expression than in the prior than in the current study (table 17).

5.9 Impact

Table 18 – Areas of impact

	Correia (2004)	Current Study
Higher discipline and accuracy	100%	80%
Contact network increase	67%	90%
Enhanced management skills	67%	70%
Strategic planning	83%	60%
Financial area	67%	40%

In the current research, the areas of major impact after the VC investment were: increasing network of contacts, higher discipline and rigor, professional management, strategic planning and finance. Correia (2004) notes that the companies, after the VC investment, obtain: more discipline, rigor, transparency, professionalism and strategic planning. The results of both studies are similar, though discipline, rigor, strategic planning and finance are more evident in Correia's (2004) study. Besides, in the present study, the increased network of contacts is more noted (table 18).

In summary, the major differences between Correia (2004)'s and the present study are: the perception that VC managers have on the broadening of VC is more positive now than it

was in 2004; investment's size and project's development stage were much more emphasized in the present study; terms of the shareholders' agreement as reporting and non-competition clauses were more relevant in the study conducted by Correia (2004); intervention at various levels was similar in both studies, although there is more emphasis of planning in our study, at the financial and operational levels; the exit through buy-back was often mentioned in Correia (2004); at the impact level, discipline, rigor, strategic and finance planning stand out in the study conducted by Correia (2004); the current study emphasized more on the increase of the investee's network of contacts.

6. Conclusions, limitations and future research

This study is focused on VC activity in Portugal. The main objectives are: to analyze the selection criteria/procedures of investment opportunities, the Venture Capitalist intervention on the firm during the partnership and the impact on the VC backed firms after divestment. We also aim to examine VC evolution over the last six years by comparing our findings with those obtained by Correia (2004). In a context of financial crisis, we intend to explore its impact on the VC activity. Considering these goals, we conducted a content analysis of ten semi-structured interviews with Portuguese VC managers.

In the current research, we found an increasing Venture Capitalists' concern to divulge the activity. For instance, some Venture Capitalists advise the entrepreneurs to contact with others who have had a VC experience to obtain information before the partnership's beginning. This prior contact is important to create clearness about the activity and avoid information asymmetries and conflicts of interest. In turn, Venture Capitalists should facilitate communication with the entrepreneurs, since there is a very specific language in the field that may not be understood at the first contact. We also found a large eagerness and availability by the Venture Capitalists to cooperate in the current investigation.

The management team's characteristics are mentioned as one of the major criteria in selecting investments. The main selection procedures aim to obtain a deeper knowledge about

the entrepreneurs. Thus, the first project presentation should reflect the quality of the management team and should be personally delivered to the Venture Capitalist. In addition, we noted that Venture Capitalists reward competitive advantage and entrepreneurs' merit. These characteristics improve the possibility of Venture Capitalist to realize profit on their investment in a short term. The growing competitiveness of Venture Capitalists in Portugal encourages an active attitude in the search of investment opportunities.

There are Venture Capitalists with several investment profiles, whereby the entrepreneurs should analyze which is best suited to their company before making the proposal. The better the entrepreneurs know Venture Capitalist's investment policy, the more possibilities they have to obtain funding. It is essential that the entrepreneurs perform a brief, objective and clear first presentation, because the pre-screening functions as a filter of the opportunities that will be discussed in more detail and those that will be excluded from the outset (Kirsch, Goldfarb and Gera, 2009). Venture Capitalists emphasize that the quality of the first presentation, made by the entrepreneurs, is often below their expectations.

To begin the partnership it is essential that the investment analysis goes through due diligence process. It should be remarked that this procedure is not conducted for lack of confidence, on the contrary its intent is to have a clear picture of the company's current situation and to define a strategy to achieve the objectives. The moment VC managers decide to build an Info Memo on the opportunity and present it to an Investment Committee, the involvement becomes higher. At this stage, the goal is no longer to ascertain the business potential, but to identify possible obstacles and ways to overcome it.

We observed that the exit is vital both to Venture Capitalist and entrepreneur, so it is crucial in several decisions. The anticipation of a successful exit is present throughout the process. In Portugal there is an increased exit difficulty because there are few companies which are able to enter in the capital market. Therefore, IPO is an exit form in which the companies can hardly count on. Thus, the more frequently evidenced exit forms were trade sale and buy-back.

Venture Capitalists are actively involved in their investments but the onus of responsibility belongs to the entrepreneurs who manage the company. Venture Capitalists'

intervention occurs by close monitoring of the business and support in some areas according to the investee's needs. The Venture Capitalist can be a strong associate, with major business experience, which allows applying the best management practices of some companies into others. Moreover, Venture Capitalist has an extensive network of contacts and promotes exchange of experiences between subsidiaries. As we have seen, the higher or lower involvement of Venture Capitalist depends on the size of the investee company and its stage of development.

We found that decisions which can change the company's strategy must have the Venture Capitalist's favorable vote. These matters are typically defined in the shareholders' agreement.

We observed that Venture Capitalist aims to professionalize management through: organization; discipline; information systems that allow managers to make sustained decisions; strategy reflection and continued review of it, that is crucial in a world in constant change; and investment analysis which enable entrepreneurs to learn lessons for the future.

Regarding the impact of the financial crisis in the VC industry, we can conclude that the perceptions diverge between a negative and a positive impact. In a positive perspective, there are interesting projects that search for VC given the current difficulty to access to bank credit. The demand for VC decreased, but the quality of the opportunities that arise seems to be superior. The fact that VC starts to be associated with relevant companies in the market will be important for broadening and consolidation of this sector. On the other hand, a negative impact may arise from the crisis in consumption that has great influence in the subsidiaries' results. The current situation increases the criteria's accuracy used by the Venture Capitalists in the investments' selection. However, it can serve as a stimulus for creativity and can moderate the expectations that entrepreneurs have in their businesses. One of the major negative aspects is the fact that Venture Capitalists come across great difficulty to attract investors and raise funds. The credit scarcity makes it difficult to structure operations that combine debt with equity.

It should be noted that the current study has some limitations. The exploratory and qualitative nature of this research allowed us to first approach the subject. This should be seen

as a starting point for the hypotheses' definition. We consider interesting to continue this research, focusing attention on each stage of the process in particular. Despite the criteria used in defining the sample, it is necessary to become aware of some generalization precautions. First, in this research field, the specific legal framework of the country where studies are developed should be considered. Furthermore, the different investment profiles exhibited by Venture Capitalists are indicators of the need for some caution in generalizing results. Although generalization of results is not the qualitative methodology's aim, it would be interesting to cross the results with quantitative data. We did not implement this idea in the present study because this was not our purpose. One of our main goals was to perform a comparison with the study conducted by Correia (2004). We have decided that it would be more useful to accomplish a study that could somehow complement and be complemented by an existing research. Our intent was, on the one hand, to contribute to knowledge about the VC process in Portugal and, on the other, to update Correia's results gathered up to 2004 and by this get a panoramic idea of VC's evolution in this last seven years. Nevertheless, we have to mention that the companies that set up the samples from the two studies are slightly different. Both samples consist of Portuguese Venture Capitalists, but the VC market evolution in Portugal, since 2004 until now, has determined that the samples were not constituted by the same VC firms. Some of the Venture Capitalists in Correia's (2004) sample no longer exist, while new Venture Capitalists emerged in recent years. Despite all the cautions we had in the preparation, transcription and data analysis, the use of the interview as a data collection instrument could raise a question about its subjectivity. To mitigate this limitation, we considered additional information sources such as official documents provided by the Venture Capitalists, as well as APCRI and CMVM reports on the VC industry.

As avenues for further research, we suggest that the current study should be replicated to update, as many transformations may be predicted in this area. Bearing in mind this research results, we consider interesting the study of the Investment Committee's figure and functions, as a relevant body in the process; the detailed study of the exit forms and market liquidity, since this is the stage in which the Portuguese VC managers expressed more concern; case studies of subsidiary companies that have been successful and others that were

less successful. We also consider important: to explore the relationship between Venture Capitalists and investors that constitute their funds in order to identify forms to maintain and attract new investors; to study the relationships that may exist between Venture Capitalists and business angels in the syndication of investments, primarily in start-up projects; and to conduct a survey to measure the knowledge of Portuguese SMEs in relation to VC as a funding source. Furthermore, we believe it would be important to examine the foreign Venture Capitalists activity in the Portuguese market and to position them in relation to the Portuguese Venture Capitalists. Considering the current situation, it will also be important to study if Venture Capitalists will maintain their positions in subsidiaries for a longer period of time, until the economy recovers and becomes easier to achieve profitable divestments.

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Appendix

Interview Guide

Part I - General information

1. How many workers are there in your firm?
2. How many investee companies are there in your firm's portfolio?
3. What is the average time of investment (in years)?
4. How do you classify the broadening of VC in the Portuguese market?
(Null/Weak/Good/Very good)
5. What are the means by which firms become aware of VC?
6. What are the main reasons for the VC partnership establishment?
7. In your opinion, what is the impact of the global financial crisis on VC activity?

Part I - Identification of selection factors

1. Which are the main criteria to consider in analyzing investment opportunities?
2. Which are the procedures performed by the Venture Capitalist during the evaluation and decision-making processes?
3. What is the average necessary time mediating from the beginning of the process to the decision to invest?
4. Are Portuguese companies aware of VC existence and VC's processes?
5. Do the investee companies request assistance from external experts during the process? If so, what kind of experts do they look for? In which stage of the process does this usually occur?

Part III - Intervention forms

1. What is the average time necessary to achieve the final negotiation of the shareholders' agreement, once the decision to invest has been made?
2. In general, which clauses are defined on the shareholders' agreement?
3. During the partnership, is your intervention mainly active or passive? If it is active, provide some examples of activities you perform at strategic, financial and operational levels.
4. Which are the preferred ways of communication between the Venture Capitalist and the investee company?
5. Which are the most frequent exit scenarios considered by your firm?
6. Is the divestment always performed within the established time?

Part IV - Impact on the business

1. After divestment, which are the main changes on the investee companies?
2. In general, which are the areas of greatest VC contribution?