EXPLORING THE RELATIONSHIPS BETWEEN VENTURE CAPITAL FUNDS AND VENTURE-BACKED FIRMS: A STRATEGY PROCESS APPROACH

[a]Minoja Mario, [b]Antonio Corvino, [c]Giulia Romano and [d]Marco Tutino*

Abstract

A great deal of studies have been carried out so far to explore the impacts of private equity or venture capital (VC) investors on their portfolio companies. Most of them focus on corporate governance, management composition and skills, competences, and performance. A lesser amount of studies have been conducted on how VC investments interact with backed firms' strategy process. In the present paper we aim to shed light on this topic by investigating in which stage of backed firms' strategy process venture capitalists (VCs) invest in them and explaining this choice in the light of the value they can deliver and simultaneously extract from them in the different stages of that process. After a cross comparison of eight cases of Italian firms in which venture capital funds have acquired minority stakes, we found that these investors do not challenge the intended strategy backed firms had undertaken, but help them implement this strategy by enriching their endowments of non business-related resources and capabilities. Furthermore, VCs seem to invest when the gap between the intended strategy and implemented strategy of backed firms is at intermediate levels. While at early stages of backed firms' strategy implementation VCs tend to evaluate the risk of their investment as too high, at later stages they would not deliver a significant "value added" to backed firms themselves.

Keywords: private equity, corporate governance, performance, Italy

University of Modena and Reggio Emilia, University of Foggia,
University of Pisa, University of Roma TRE
[a] mario.minoja@unimore.it, [b] a.corvino@unifg.it, [c] g.romano@ec.unipi.it, [d] mtutino@uniroma3.it

1. Introduction and theory

Venture capital (VC) financing is a form of financial intermediation that provides financial resources and specific skills and competences to backed-firms. Existing literature on VC focuses mainly on US market. Less studies refer to European countries such as Italy, which is the fourth European country in terms of number of VC deals (European Venture Capital Association - EVCA, 2002).

Venture capitalists (VCs) are acknowledged to have significant impacts on backed-firms. Particularly, VCs may affect board composition and other corporate governance structures and mechanisms of backed companies, as well as support them in funding, strategy formulation, filling in the management team and structuring extraordinary transactions (Barry et al., 1990; Rosenstein et al., 1993; Van Den Berghe and Levrau, 2002; Caselli et al., 2006; Lindsey, 2007; Wruck, 2008; Kaplan and Strömberg, 2008). The levels of VCs involvement (MacMillan et al., 1989) and value added to backed firms seem to be different in US and UK firms with respect to those in the rest of Europe (Manigart et al., 1996). Existing literature shows also the relevance of shareholders agreements in the corporate governance of backed-firms (Sahlman, 1990; Kaplan and Strömberg, 2003; Cumming et al., 2010). However, frequent communications with top management teams generally help minimize conflicts (Perry, 1988; Sapienza, 1992).

An EVCA study (2002) analysed the economic and social impact of venture capitalists on European firms that are in seed, start up or expansion stages. The research shows that venture capital investment is crucial to the existence, feasibility and success of companies. Around 90% of responding venture-backed companies declared an increase in the total number of employees following the venture capital investment and over half the respondents believed to have overperformed their competitors in the post-investment period.

In their study on UK large private equity deals, Acharaya et al. (2009) found that higher margin growth is associated with greater interaction intensity of private equity houses with backed firms mainly during the early phase of the deal, through providing top management with complementary external

support. These results are consistent with the received wisdom that mature private equity houses create value for portfolio companies through active ownership and governance (Acharaya et al., 2009). As far as the Italian context, a recent PricewaterhouseCoopers study (2008) shows that private equity and venture capital in Italy have a positive economic impact on portfolio companies. Sales, Ebitda and employment grow significantly in private equity and venture backed companies, and, more relevant, much more than economic indicators and benchmark companies.

However, to our knowledge, no specific studies have been conducted so far to investigate in which stage of backed firms' strategy process VCs invest in them and to explain this choice in the light of the value they can deliver and simultaneously extract from them in the different stages of that process. In our explorative study we focused on venture-backed firms where a VC fund acquired a minority stake and majority shareholders – often the founder, his descendants or his family members – still control the firm after the deal. These controlling shareholders are generally involved in running the company by directly taking executive positions or by choosing managers (Melis, 2000). Therefore, VCs with minority stakes frequently interact with them. Instead, in the US, where VC-backed ventures median shares for CEO and top management team are relatively high (13 and 37.5 percent, respectively, in 1994: see e.g. Sapienza and Gupta, 1994), frequent interactions occur between VCs and top management teams.

To that purpose we studied eight cases of Italian companies where a VC fund acquired a minority stake. We thus investigated the impacts of VCs on several domains of each of these firms: first, on their corporate governance, since it is at this level that main firm goals are defined and guidelines for strategy formulation are decided. Second, on top management team composition, as it is responsible of strategy formulation, as well as on managerial skills and practices, which impact on strategy implementation. Third, on backed firms' strategy, in terms of both intensity and mode of growth, as well as of activities carried out to achieve or reinforce competitive advantage.

We finally propose a dynamic model that helps shed light on how and when VC funds are involved in backed firms' strategy process, as well as on how they deliver value to them.

2. Methodology and data collection

A typical problem in the investigation of corporate governance and management issues is the scarce availability of information due to the confidential nature of these data. This issue is particularly significant for private companies such as those that receive VC financing (Bonini et al., 2009). Consequently, we chose to follow what literature defines "*multiple case design*" (Bourgeois and Eisenhardt, 1988; Eisenhardt and Graebner, 2007), which allowed us to have access to a massive amount of information not available from secondary sources. A multiple case approach - as stated in main literature on this research methodology (Yin, 1984) – is based on a replication logic, since it allows to treat a series of cases as a series of experiments. Hence, each case study can confirm or disconfirm the inferences drawn from previous one. It is useful in offering a more reliable model in terms of construct validity, external validity and internal validity (Yin, 1984).

First of all, we developed contacts with a large number of fund managers who directly keep contacts with backed companies. We directly interviewed nine VC fund managers. This previous step helped us in picking up companies with different characteristics "in order to more easily observe contrasting patterns in the data" (Eisenhardt and Graebner, 2007: 27).

We thus studied eight Italian companies which received a minority financing by a venture capital fund. We chose firms that are different in terms of business sector, size (in terms of sales, number of employees and total assets), VC fund type, equity stake acquired by VC fund etc. (Table 1). We limit our analysis to companies that receive an expansion financing in 2005 and 2006, in order, firstly, to be sure that management have fresh in mind all the deal aspects and, secondly, to be able to analyse a period of at least two years after the VC deal, but not significantly impacted by the effects of the great financial crisis that started at the end of 2008.

For each company we investigated on changes produced by a VC investment by keeping traces of a great deal of elements through the intensive use of documents and direct interviews. Multiple sources of data allow the triangulation of evidence. As a matter of fact, we collected data from 46 annual or, when available, consolidated financial statements of the eight companies from 2003 to 2008, other public documents (such as newspaper articles, press releases etc.), and ten direct interviews.

For each company we interviewed the CEO, a Director or another top manager who have contacts with the VC fund and had a relevant role in the deal. Frequently the CEO is also a member of the controlling group. Interviews followed a replication logic and a common protocol. Each interview was conducted by two researchers, both responsible of taking notes, in order to collect all useful information. After the interviews each investigator recorded his notes and impressions following different rules currently adopted in case study analysis (Yin, 1984). The first one is the "24 hour rule", requiring that all the notes written were recorded within one day after the interviews. The second rule was to include all the data collected. The third one was to take notes of our impressions separately from the "story".

Following Eisenhardt (1989), after the within-case analysis, aimed at gaining familiarity with data and generating preliminary theory, we focused on the cross-case search for patterns, to look beyond initial impressions. We thus selected categories such as large or small and medium-sized enterprises (SMEs), using European Union criteria, or VC fund type and then look for within-group similarities together with intergroup differences. Finally we searched for similarities and differences between cases. The cross-case comparison allowed us to clarify whether an emergent finding is simply idiosyncratic to a single case or consistently replicated by several cases (Eisenhardt and Graebner, 2007).

Table 1. An overview of the eight case studies

Company	**Alpha**	**Beta**	**Gamma**	**Delta**	**Epsilon**	**Kappa**	**Iota**	**Omega**
Firm size	Large	Large	Large	SME	SME	SME	SME	SME
Industry	Facilities management	Transportation	Biotechnology	Food and beverage	Production of packaging	Production of doors and windows	Production of hydraulic cylinders	Commercialization and rent of chemical WC
VC investment year	**2005**	**2006**	**2006**	**2006**	**2006**	**2005**	**2006**	**2006**
Employees in the investment year	6.800	2.200	600	200	100	50	30	10
Sales (€/mln) in the investment year	450	760	155	10	40	6	27	25
Total assets (€/mln) in the investment year	421	333	256	19	26	11	34	16
Lead VC Fund Type: management company	bank owned	bank owned	independent	independent	independent	local bank owned	bank owned	bank owned
VC Equity Stake (%)	25%	7,5%	40%	47%	35%	17.5%	27,5%	24%
VC Investment amount (€/mln)	8	7,9	n.a.	7,5	5	1,5	2,5	5
Interview to:	CEO	A Director (a VC representative) and a manager	CEO	CEO	General Manager	CEO (who is the founder and one of the majority shareholders)	A manager and a VCs	A Director appointed by the majority shareholders

3. Results

3.1. Venture capital impact on corporate governance

In line with previous studies (Barry et al., 1990; Sahlman; 1990; Van Den Berghe and Levrau, 2002), our empirical evidence (Table 2) shows that venture capitalists choose to manage and monitor their investments by appointing their own representatives in boards as well as in boards of auditors, a statutory and mandatory control board typical of the Italian corporate governance system (Melis, 2004). However, contrary to Rosenstein et al. (1993) findings, we found that VCs never appoint the majority of Board members, which is consistent with the minority stake they acquired. However, in six out of the eight cases the percentage of VCs' representatives in the boards is greater than their percentage of shares.

The only two firms where the percentage of VC representatives in the boards is lower than their percentage of shares are both SMEs and backed by a fund with an independent management company. Independent management companies invest in three out of eight firms and they took the highest percentage of shares among the cases analysed.

Furthermore, in all the eight companies we studied, shareholders agreements allow VCs to protect their interests through a veto power on many relevant decisions and sometimes even for on going operations.

While in large firms an audit company had been appointed before the VC deal, in medium and small sized companies an independent audit was required by VCs.

Table 2. Summary of corporate governance issues in the eight case studies

		Backed companies	Alpha	Beta	Gamma	Delta	Epsilon	Kappa	Iota	Omega
		Firm size	Large	Large	Large	SME	SME	SME	SME	SME
		Lead VC Fund Type: management company	bank owned	bank owned	independent	independent	independent	local bank owned	bank owned	bank owned
VCs minority stakes		VC Equity stake (%)	5%	7,5%	40%	47%	35%	17,5%	28%	24%
VC interest protection mechanisms rather than VC direct involvement in decision making	Appointment of a minority of directors and of board of auditors members by VCs	N° of board directors	11	3	7	5	7	3	5	9
		N° of VC representative directors	4	1	3	2[65]	2	1	2	4
		Weight of VC representative directors	36%	33%	43%	40%	29%	33%	40%	44%
		N° of board of auditors members	3	3	3	3	3	3	3	3
		N° of VC representative board of auditors members	1	1	1	1	1	1	1	0
		Weight of VC representative board of auditors members	33%	33%	33%	33%	33%	33%	33%	0%
		VC's veto power	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
		Audit firm	Pre-existing	Pre-existing	Pre-existing	After the deal	After the deal	After the deal	After the deal	After the deal
		***Non-compete clause*s**	No	No	No	No	Yes	No	No	Yes
Unchanged governance structures and mechanisms		Introduction of performance-based compensation systems	No	No	No	Yes	No	No	Yes	No
		Change of President or CEO after the VC investment	No	No	No	No	No	No	Yes, a fund manager has become CEO	No
		CEO and President are different	No	No	No	No	Yes, since before the deal	No	Yes, after the deal	Yes since before the deal
Improved governance working		Impact on board meetings' frequency and regularity	None	Increased frequency and regularity of board meetings	Increased frequency and regularity of board meetings	Increased frequency and regularity of board meetings	None	Increased frequency and regularity of board meetings	Increased frequency of board meetings	Increased frequency and regularity of board meetings

[65] In case of Delta, the two VC representative directors are external professionals (independent directors).

In all the cases we analysed frequent informal meetings and contacts between VC funds and firm managers allow VCs to be constantly informed about firm activities and the degree of achievement of goals shared before the deal. In fact, in line with Gorman and Sahlman (1989), we found that VCs visit their companies relatively frequently and several telephone conversations fill the gaps between visits. Confirming Fried and Hisrich (1995) findings, we report that many top managers often contact their VCs outside of regular board meetings in order to meet their help in bouncing off ideas.

Only in one case VCs imposed the appointment of two independent directors and in another one the former CEO was replaced with a VC representative. In no case the President is a VC representative. While in one firm shareholder agreements would give the fund the possibility to appoint its own Chairman, the previous one, a majority shareholders, ***has been confirmed in this role in order "to give continuity and trust to the family business management".***

In only two firms performance-based management compensation systems were introduced to ensure a better interest alignment between shareholders and managers, as recommended by the agency perspective. Existing literature on corporate governance suggests that the separation between the CEO and President roles ensures a better power balance within a firm (Fama and Jensen, 1983; Jensen, 1993), even if some researchers highlight also the potential costs associated with a separation of the two functions (Brickley, Coles, and Jarrell, 1997; Dahya and Travlos, 2000). In two out of the eight firms these two roles were separated well before the VC took a stake, in just one of the six remaining cases the VC imposed their separation.

According to an interviewee "after the deal, the fund managers tried to introduced corporate governance best practices". As a matter of fact, after the VC investment the frequency of board meetings increased in six out of eight cases; moreover, in five of these cases also the meetings regularity improved. .

Two major findings emerge from our comparison of backed firms' corporate governance before and after VCs' investment. The first one is that VCs do not lead to significant changes of corporate governance structures and mechanisms, but introduce improvements in terms of board "discipline", leading it to assume a more substantial, and not merely formal, role in firm governance. The second one is that VC funds never assume the control of the boards through the appointment of the majority of their members, neither they pretend to change majority shareholders' representatives. Rather, they aim to achieve adequate representation and protection of their interests within the existing governance framework. Stated differently, they only take a control role. Both these findings cannot be simply interpreted as a "natural" consequence of the minority stake VCs have acquired, but also a sign that they trust in majority shareholders' representatives and do not challenge strategic guidelines they had assigned to executives.

3.2. Venture capital impact on managerial skills and practices

Our results (Table 3) suggest that VCs considered the business related competencies of the existing management team strong and essential to complete the firm strategic design implementation. In six out of eight venture-backed firms, management teams remained unchanged. Only in one firm a fund manager became the CEO; in another one the CFO was appointed by the fund, but, after only one year, he was replaced by a new manager, chosen by the majority shareholders, since "*he didn't really and fully understand the core business*".

As a matter of fact, VCs were not involved – except for one case – in backed firms' strategy formulation processes, but supported managers in their efforts aimed at implementing previously designed strategies. They preferred to cooperate with existing top management teams through frequent, informal interactions. This is in line with entrepreneurs and managers' mindsets, as they believe that VCs view strategy as primarily a management task (Fried et al., 1998; Fried and Hisrich, 1995). We found that VCs leave wide autonomy to management, whilst maintaining a supervisory role and improving managerial processes formalization (in four out of eight cases). As a manager told us, "*the fund mainly monitored the achievement of business plan and budget goals*".

Our findings suggest that VC investments led to significant improvements of existing managers' skills and practices in many "technical", "no business-specific" functions or domains, like management control and corporate finance, mainly in SMEs.

In particular, VCs led to introduce or improve performance evaluation tools (such as variance analysis, scorecards and other reporting systems) in six firms; planning tools such as budget and business plan were introduced or improved in four firms.

Large companies had already implemented adequate performance evaluation and planning tools before the VC investment: nevertheless, VCs led to a more widespread and timely use of managerial accounting reports and had a monitoring role on goals achievements through new KPIs or tools.

VCs assisted and supported backed-firms in negotiating and obtaining debt financing and improving banking relationships in six cases. Interviewees of these six firms highlighted that VC enhanced corporate image and trustworthiness (Baeyens and Manigart, 2003). Two entrepreneurs stated that "the fund presence improve significantly the relationships with banking system".

Table 3. Summary of VC impact on backed firms' managerial skills and practices

			Backed companies							
			Alpha	**Beta**	**Gamma**	**Delta**	**Epsilon**	**Kappa**	**Iota**	**Omega**
Firm size			Large	Large	Large	SME	SME	SME	SME	SME
Lead VC Fund Type: management company			Bank owned	Bank owned	Independent	Independent	Independent	Local banks owned	Bank owned	Bank owned
VC Equity stake (%)			5%	7,5%	40%	47%	35%	17,5%	27,5%	24%
Management team change			No	No	No	The fund chooses a new CFO	No	No	A fund manager becomes CEO	No
Significant improvements of existing managers' skills and practices in many "technical", "no business-specific" functions or domains	*Management control*	Performance evaluation tools	KPI monitored more frequently New tool (EVA)	New KPIs	KPI monitored more frequently	New reporting system	KPI reduced and more financially oriented	None	New reporting system	KPI monitored more frequently and at group level
	Management control	Planning tools	More formalization and clearness	None	None	Introduction of budget and business plan	None	None	Introduction of budget and business plan	Introduction of consolidated business plan
	Corporate finance & Banking relationship		Improve banking relationships	Continuous support in negotiating debt financing	Continuous support in negotiating debt financing	Improve banking relationships	None	Obtaining more debt financing	None	Continuous support in negotiating debt financing
	M&A & Partnerships (joint ventures, franchising etc)		Financial support for acquisition	Support for M&A legal and contractual aspects Support for scouting target firms for M&A	Support for M&A legal and contractual aspects Support for scouting target firms for M&A	Financial support for acquisition abroad	None	Financial support for acquisition abroad	Financial support for acquisition abroad and for legal and contractual aspects	None
	M&A & Partnerships (joint ventures, franchising etc)		Support for partnerships	None	None	Support for partnerships	None	Financial support for partnership (joint venture and franchising network)	Support on joint ventures legal and contractual aspects	None
Increase of managerial processes formalization			More discipline and process formalization	None	None	Definition of roles and functions, formalization of decision process and introduction of incentive scheme for middle management	None	None	Formalization of decision process	More discipline and process formalization

It is worthwhile pointing out that in one case the backed-firm obtained large amounts of loans provided by banks that directly controlled the VC fund. A so large capital availability, combined with fund pressure, led to undertake too many risky investments simultaneously and without adequate managerial skills to sustain a very ambitious growth strategy. The survival of this firm (Kappa) was severely undermined.

Furthermore, VCs ensured an important support in M&A and partnerships such as joint ventures and franchising. In six cases VCs had a relevant advisory role mainly related to legal and contractual aspects of the deals; in two of these cases (two large firms) they had also a role in scouting target firms.

Drawing on our empirical results, we argue that VCs invested in firms where existing majority shareholders and top managers have strong business related competencies essential to manage the company and to achieve, or enhance, competitive advantage. Hence, VCs did not challenge the backed firms intended strategy and left wide autonomy to firm management, giving them a support in its implementation. VCs significantly contributed to

improve or reinforce existing managers' skills and capabilities in many "technical", "no business-specific" functions or domains such as corporate finance and management control, as well as to introduce some best practices.

3.3. Venture capital impact on growth and strategy

Our empirical evidence (Table 4) suggests that VC investments helped backed firms continue a growth process that they had started some years before the deal. Available financial data, that cover the period from two years before (hence from 2003 or 2004) to two years after the deal (hence until 2007 or 2008), show that only in one case the total asset CAGR is higher before than after the deal. Hence, VCs seem not to be determinant in starting and fostering growth processes. Rather, they are involved once backed firms have already significantly grown, thus helping them complete their expansion processes. Similar results emerge if sales are considered instead of total assets. As the CEO of Gamma said "the fund stimulated us to pursue a healthy growth strategy".

Table 4. Summary of growth and strategy issues in the eight case studies

	Alpha	Beta	Gamma	Delta	Epsilon	Kappa	Iota	Omega
Firm size	Large	Large	Large	SME	SME	SME	SME	SME
Lead VC Fund Type	Italian bank owned management company	Italian bank owned management company	Italian independent management company	Italian independent management company	Italian independent management company	Italian bank owned management company	Italian bank owned management company	Italian bank owned management company
Total assets CAGR in 2 years before the deal	n.a.*	14,4%	6,0%	262,8%	-0,2%	27,5%	49,0%	15,8%
Total assets CAGR in 2 years after the deal	18,9%	1,9%	10,4%	17,6%	-0,1%	11,1%	28,9%	14,8%
Internationalization after the VC deal	Opening up of new markets in France and in Poland	Opening up of new markets	Increase of production capacity abroad	Opening up of new markets in England, Brasil, Argentina, Finland and Nederlands	Opening up of new markets	Opening up of new markets in Spain and in the United Arab Emirates (e.g. Dubai)	Opening up of new markets in Australia and South Africa	Opening up of new markets (e.g. China)
M&A and partnership after the VC deal	Acquisition of an Italian competitor	New partnerships abroad	Acquisition of a firm and new joint venture in Mexico	New joint ventures (e.g. *franchisees*) in England, Brasil, Argentina, Finland and Nederlands	No	Acquisition of an Italian firm to broaden product range; Partnership in the Middle East; New franchising distribution network in Italy	Buy up of an Italian subcontractor and joint ventures in Australia and South Africa	Joint ventures in Africa and Middle East
R&D investments after the VC deal	No	No	No	Launching of new brands	New investments for improving productive efficiency	High tech investments in the main manufacturing plant	Launching of new products	No

*These data are not available because the firm has been set up on December 2003.

Our findings suggest that VCs do not lead to accelerate growth, but, rather, to reorient it in new, relatively unexplored directions such as internationalization, M&A and partnerships, R&D investments. As a matter of fact, in all the eight cases we studied VCs provided a significant support in pursuing internationalization strategies, either through entering new geographic markets (seven cases) or building new production capacity abroad (one case). An entrepreneur of a SME acknowledged that the "VC fund gave us the trust for entering into an international market", and another one confirmed that "we looked for a VC fund in order to sustain our internationalization process".

VC funds have also supported seven out of eight backed firms in their external growth, either at national or international level. Thanks to VC's financial and consulting support, four companies took the control of a competitor or of a subcontractor; six firms have developed joint ventures or other forms of partnership in order to strengthen their sales network in Italy or abroad.

It is worthwhile remarking that no significant differences emerge between large firms and SMEs as far as their internationalization and external growth strategies after VC funds entered their capital.

As far as R&D investments, VCs seem to have supported only SMEs, whose investments were aimed at improving efficiency or technological level in

manufacturing plants or launching new products and brands. Taken together, our empirical evidence suggests that VC funds do not play an active role in strategy formulation of backed firms. As a fund manager has effectively explained, "We do not want confusion of roles". Rather, they support backed firms in exploiting the potential embedded in their intended strategy, without impairing entrepreneurs' or managers' freedom of initiative. One of the entrepreneur we have interviewed observed that "VC fund has enabled us to run our business freely". Moreover, VCs seem to select companies that have already achieved a competitive advantage in some markets and encourage or support them to exploit it in new domains. The CEO of a restaurant chain company explained that the VC fund had decided to invest after a deep assessment of the sustainability of its competitive advantage, whose sources are "a high raw material quality, excellent service, an internal school for training people in charge to open new restaurants of the chain, which makes it possible to have a uniform quality across our points of sale". An entrepreneur explained us that "the fund backed a company with a good and promising track record and its role has been limited to monitor management choices and to create value".

In conclusion, our findings suggest that VCs, either independent management companies or owned by banks, do not play primarily the role of financial backers, let alone of strategy designers. Rather, they act as coaches for both managers and shareholders actively involved in running their companies. One of the eight cases (Kappa) represents an exception, as the VC fund was actively involved in strategy decision making, leading the entrepreneur to assert that "the fund, in spite of its minority stake, took the control *de facto* of the company". The huge path of growth imposed by the fund severely compromised both competitive advantage and financial soundness of that firm, that is still fighting to avoid bankruptcy.

4. Emerging patterns of VC involvement: a strategy process approach

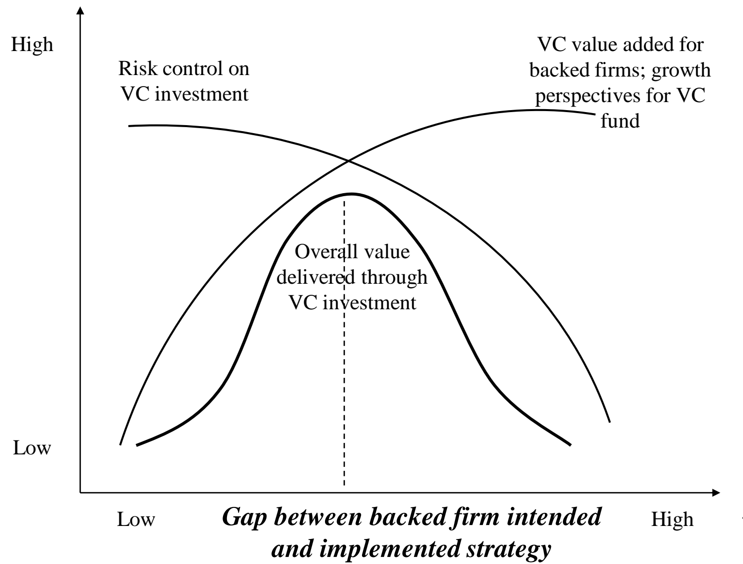
An in-depth analysis of eight cases of VC minority investments in Italian firms allowed us to observe some emerging patterns of VC activation and involvement in the context of strategy process of backed firms. System dynamics (see e.g. Forrester 1961, 1968) seems to be a particularly suitable tool for explaining how VCs can be activated by majority shareholders or entrepreneurs in order to fully implement a planned strategy. System dynamics – in its basic logic – is aimed at representing and explaining the cause-effect relationships that connect stock variables and flow variables to form feedback loops. Thus, it is a useful approach to explain how a given phenomenon evolves over time.

Drawing on our empirical analysis, we argue that backed firms attract VC funds through an ambitious and promising strategy conceived by the majority shareholders or by top managers they had appointed in terms of both desired competitive advantage and wideness of the competitive arena(s) to be dominated. The last, in turn, is defined in terms of geographic markets, industry segments, or vertical integration. Generally, this intended strategy has been only partially implemented at the time of VC investment: a firm may have reached a competitive advantage in one or just few countries and aim to exploit it in more geographic areas, or envisages interesting opportunities of investment in related domains. While the perception of a gap between intended strategy and implemented strategy leads firm owners to look for a VC financing as a way to reduce or fill it, the combined acknowledgment of the results that firm had already achieved and of further potential embedded in the intended strategy makes the investment attractive for VC fund.

To a closer insight, our findings suggest that VC funds invest in a firm when the gap between its intended strategy and its implemented strategy is at intermediate levels. In fact, at early stages of strategy implementation – or for high levels of this gap –, investment may be perceived as too risky: even though a given intended strategy can be assessed as valuable *per se*, only its actual implementation provides evidence that it can deliver its potential value within that specific firm with its own set of resources and competences. By contrast, when an intended strategy is close to its implementation – or the gap is low – the low level of investment risk for VC is more than offset by the low perspectives of growth and also by the scarce incentive of the firm to have access to a VC's capital. Thus, we can argue that the relationship that links the gap between backed firms intended and implemented strategies, on the one hand, and the overall value delivered by the VC fund, on the other, is U-reverse shaped (figure 1).

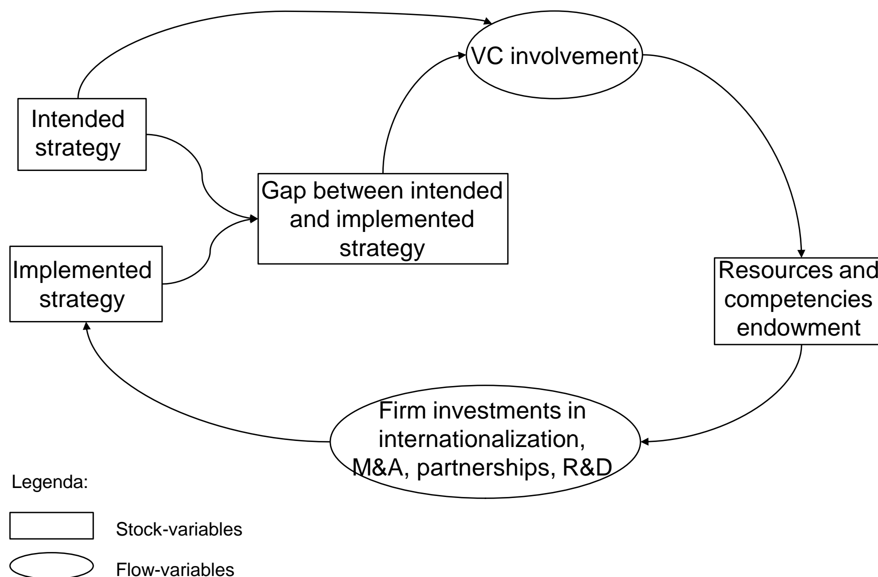
Once involved, VC funds positively impact on the resources and competencies (e.g. Barney, 1991) endowment of backed firms through different processes: by directly providing financial resources as well as technical, not business specific competences like those related to M&A, internationalization and corporate finance; by signalling opportunities; by leveraging external resources, that is by facilitating or catalysing access to resources thanks to improved firm reputation and trust on different markets; through managerial fertilization, that is by reinforcing managers' skills and capabilities. Following a broader resources and competencies perspective, VCs positively impact also on organizational discipline – by imposing use of better governance processes, more evolved managerial accounting tools, and more formal organizational mechanisms – as well as on managerial self-confidence.

Figure 1 - The U-reverse shaped relationship linking backed firm gap between intended and implemented strategy and overall value delivered through VC investment



A richer resources and competencies endowment, as well as direct VC support, made top management team to undertake M&A, to be engaged in new partnerships, to develop new products or processes, to enter new geographic markets. As a result, the gap between intended and implemented strategies tends to decrease cases after the VC involvement (figure 2).

Figure 2 – Emerging patterns of VC involvement: a dynamic model



Our approach to strategy process is similar to Burgelman's (1991, 2002) internal ecology model of strategy making, that distinguishes between variation-reducing, induced strategic processes and variation increasing, autonomous strategic processes. While the former are ultimately made at implementing the

organization's current strategy and build on existing knowledge, the latter include actions and initiatives that emerge outside current strategy's scope and involve the creation of new competencies (Raisch and Birkinshaw, 2008). Our findings suggest that VCs are involved to reduce rather increase variation, since they bring into backed firms generic resources and competences that are expected to mobilize, exploit, leverage on existing, business related, firm idiosyncratic knowledge.

It is interesting to note that the dynamic process that links together firm strategies, VC involvement, resources and competencies endowment and flows of investments can be iterated – and in some cases it actually was – at different times and different stages of strategy implementation. In some of cases we studied a second, more specialized VC was subsequently involved; some firms looked at VC involvement as an intermediate stage that would helped them to meet the organizational, cultural as well as financial conditions required to become public.

Another interesting finding of our research is that in no case VCs have challenged the intended strategy. They seem to have invested in a given firm just because they positively evaluated its strategy and believed that their own investment would have facilitated its implementation, thus leading it to deliver its value creation potential.

In one of the eight cases we analysed the results achieved after the VC deal were so bad that, in spite of its competitive advantage and financial soundness just before the deal, the backed firm arrived at a point very closed to bankruptcy. How could we interpret this case in the light of our theoretical development? Or, rather, how and to what extent does it challenge our theory? A close observation of facts leads us to interpret that failure as a consequence of a combination of unsatisfactory returns of a huge amount of investments and of opportunistic behaviour of VC. The latter was actively involved in managerial choices and forced to undertake investments (acquisitions and set up of new plants abroad) financed by loans provided by banks that directly controlled the VC fund. Therefore, this case seems to add further insights to our theoretical approach, in that it suggests that the pattern of VC involvement we observed in seven out of the eight cases we studied is also the most suited for value creation through minority investment in backed firms. A clear distinction of roles, complementary resources and competences, managerial fertilization and support seem to maximize the value that VCs deliver to backed firms.

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