

KNOWLEDGE FUND: A STRUCTURAL PROPOSITION FOR THE EMERGING V2C INDUSTRY

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ABSTRACT

Thanks to several fundamental developments, since the collapse of communism in Europe, both mental and physical barriers to start ambitious entrepreneurial ventures are lower than ever in the whole world. Consequently, both the demand and supply of venture capital (VC) financing have soared, phenomenally, since 1995. However, due to the VC spiral, supply does not meet demand in the growth company process. There is no lack of investors of (hands off) financial capital into established businesses, but a serious shortage of investors of (hands on) knowledge capital into early stage ventures. And the few there are of those pushing ventures to (venture) capital – as players of the emerging venture-to-capital (V2C) industry – operate from a fragmented set of structures and offer no concept of industry to their key stakeholders. Based on existing wisdom on strategy logic of the venture capitalist, this conceptual paper provides a structural proposition for the emerging V2C industry. The concept of a Knowledge Fund is mentally probed from four perspectives: (1) entrepreneurs, (2) V2C players, (3) VC players, and (4) government. The primary mission, herein, is to share a social innovation, refine core concepts, and propose directions for empirical research in the V2C space.

INTRODUCTION

The importance of ambitious entrepreneurs and their ventures to economic wealth and job creation is, by any measure, unarguable. Thanks to:

- (i) the collapse of communism in Europe, in 1991, and the subsequent rise of appreciation of entrepreneurship throughout the world, and
- (ii) the emergence of ICT enabled business concepts – that followed the end of the Cold War – which rapidly convert start-ups, and business in general, from capital intensive to knowledge intensive,

both mental and physical barriers to start new business ventures are lower than ever in the whole world. Since 1995, these developments accumulated an unforeseen rise in the demand for venture capital financing – and an unforeseen rise in the supply of the same. (Seppä 2000)

However, according to the basic observations that triggered this research, in 2001, the unforeseen growth in both the demand and supply of venture capital financing, in the go-go years of 1995-2000, yielded a long-lasting paradox. Whereas the average size of a venture capital fund (and the size of a minimum investment) has grown exponentially, the ventures seeking for financing have, at the same time, transformed from capital intensive to increasingly knowledge (hands-on) intensive. While there for once has been no shortage of

capital, there is – paradoxically – a shortage of small (and knowledge intensive) enough doses of it. (Murray 1999; Sohl 1999; Seppä & Näsi 2001; Rasila 2004)

The effects of the VC spiral, depicted by Seppä (2000), were already noted as a potential future concern by Bygrave and Timmons (1992) in their landmark book: *Venture capital at the crossroads*. In result, aside of the classic Capital Gap (originally labelled as the Macmillan Gap in 1931), Knowledge Gap has emerged between new venture activity and the venture capital industry. (Seppä & Näsi 2001; Rasila, Seppä & Hannula 2002; Rasila 2004; Bartlett 1999). This development owes to the transformation of kin to industrialisation – referred to as electronisation, digitisation and knowledgisation – which is under way in the society: A transformation marked by, e.g., conversion from capital intensive to increasingly knowledge intensive business models and transition from value chains to value networks in the creation of economic value added. (Eliasson 2001; eBRC 2001-2004)

Industrialisation, the conversion from agricultural to industrial economy, was marked by the Capital Gap, a shortage of financial capital. Knowledgisation, the ongoing conversion from the industrial economy to knowledge economy, is marked by Knowledge Gap, a shortage of knowledge capital. Whereas the Capital Gap became bridged by financial capital investors referred to as business angels and venture capitalists – or the venture capital (VC) industry – the Knowledge Gap is being bridged by knowledge capital investors referred to, in this research, as knowledge angels or co-entrepreneurs and venture knowledgists – or the venture-to-capital (V2C) industry.

THE RISE OF THE V2C INDUSTRY AND THE NEED FOR STRUCTURAL SOLUTIONS

The observations of the Knowledge Gap and of the innovative ways to bridge ventures and capital – that led to the conceptualisation of venture-to-capital (V2C) activity – derive from E-Forum, the EU (FP5) funded research project that also marked the launch of eBRC, one of the six sub programs of eTampere, in 2001. E-Forum, coordinated by Technology Centre Hermia Ltd. in Tampere, Finland, and involving partners from six different countries, analysed and sought for new solutions for the matching of (early stage) ventures and (venture) capital in different parts of Europe. In the context of E-Forum, a seminal typology of V2C actors was constructed. (Seppä & Näsi 2001)

Most recently, V2C players have become classified as knowledge capital investors who by aligning the interests of entrepreneurs (the ultimate knowledge capital investors) and venture capitalists (financial capital investors), as co-entrepreneurs or venture knowledgists, bridge the knowledge gap by pushing ventures to capital. Whereas financial capital investors, in the private equity arena, have become classified as formal VC investors or venture capitalists and informal VC investors or business angels, knowledge capital investors are being classified as formal V2C investors or venture knowledgists, and informal V2C investors or knowledge angels or co-entrepreneurs. (Harrison, Jungman & Seppä 2004; Jungman & Seppä 2004)

Through its seminal conceptual evolution, culminating in the proposition for a new paradigm for growth venturing by Rasila (2004), V2C has conceptually remained a mainly European concern. In America, the more traditional value chain – comprising entrepreneurs, family and friends, business angels, and venture capitalists – continues to more efficiently bridge both

the Capital Gap and the Knowledge Gap, than in Europe, excluding the UK. It is rather safe to assume that start-up entrepreneurs are, on average, better equipped in America than Europe, both by experience and mentality, to face the challenges of young, rapidly growing companies. Also, the level of private savings and supply of business angel financing assure a dynamic, market-based, and market-driven upbringing to young ventures. In Europe, the process has to be compromised by public sector intervention, starting from the go/no-go decision. Instead of fellow principal operators, entrepreneurs have to interact with government officers and/or consultants operating as government agents.

In this light, Europe, particularly Finland, is only a logical home for the conceptualisation of V2C, and the call for informal knowledge investors, as well as a formal V2C industry. Finland boasts top ratings in world rankings in terms of ICT, innovation activity, R&D investments, and knowledge intensity (World Economic Forum 2005). From one hand, it is safe to assume, Finland has a world class environment to spur prospective ventures. From the other hand, due to cultural issues, historical confrontations, and tax policies, Finland suffers from extremely low level of business angel activity. According to GEM 2002, Finland is among the countries with lowest rate of informal investment as a percentage of GDP (Reynolds, Bygrave, Autio, Cox & Hay 2002; see also Bygrave, Hay & Reynolds 2003; for more detailed documentation on business angel activity in Finland see Lumme, Mason & Suomi 1998). To utilise the country's obvious potential, the government sector has been very active in the early stage arena, both on national, regional, and local level. Government leadership, topped with apparent shortcomings in the entrepreneurial culture, in appreciation of go-gettedness, market-aggressiveness, and associated drive for wealth creation, have a constituted for a lock-up where good intentions – the ways and forms, by which growth resources are being offered – paradoxically, only prevent success.

It has been proved in several studies that business angel financing is an invaluable phase before formal venture capital financing. In particular, the non-financial contributions of business angels are greatly valued by entrepreneurs. (Harrison & Mason 2000; Madill, Haines & Riding 2005) The non-financial contribution can be divided into six categories: advice, contacts, hands-on assistance, boards of directors and advisors, market and business intelligence, and credibility/validation (Madill et al. 2005). In short, V2C (or knowledge investing) deals with the investments of only (mainly) the non-financial contribution and defining it as knowledge capital. Knowledge capital – and herein also Knowledge Gap, knowledge investment and Knowledge Fund – refer to both explicit and tacit knowledge. Into knowledge are, herein, also embedded individual experience, personal beliefs, perspectives, and values. (Nonaka & Takeuchi 1995) In this study knowledge can also be as synonym to businessman wisdom including entrepreneurial capacity, which underlines companionship and the intensity of the relationship between entrepreneur and knowledge investor.

At any rate, Finland, suffering from a lack of business angels has had a need to find alternative ways to channel similar contributions to young start-ups. Madill et al. (2005) found three alternative sources for the non-financial contributions of business angels: (i) doing it self, (ii) paying for the contribution, and (iii) from boards of directors. At least in the case of Finland, it seems that these means are not sufficient enough. Namely, in European and global comparisons, Finland still lags behind in the relative number of growth companies that truly break through to international markets (see e.g. Hyrsky & Lipponen 2004). According to many indicators, such as EU's Innovation Index, the Finnish innovation environment ranks among the top of the world. (European Commission 2004) Yet only few

ventures emerge as truly successful growth companies. It is being argued that this is due to lack of related business know-how. (Paasivirta & Valtonen 2004). By 2004, as a sign of conceptual acknowledgement and awareness, the development and support of “V2C activity and co-entrepreneurship” were referred to as key means to improve the matching of ventures and capital, in a government report, in Finland (Ryynänen 2004).

Instead of financial capital, V2C players primarily invest knowledge capital in order to build ‘prospective’ entrepreneurial ventures ‘investable’ in the eyes of the venture capital industry. Interestingly, informal knowledge capital investors are emerging even in Silicon Valley (Komisar 2001; Rasila 2004). Harrison et al. (2004) find case-based support for the rise of knowledge angels and V2C to complement business angels and VC. At present, the V2C field comprises a diverse group of actors operating from a fragmented set of structures and offer no concept of industry to their key stakeholders. Similarly, in the late 1970s and early 1980s business angels formed “an informal, word-of-mouth network dominated by ‘lone wolf’ chequebook angels” making ad-hoc investments. From those days the angel investing scene has changed a lot and today there is a huge amount of business angel clubs, structured groups and networks operating around the world. (May 2002)

In this research, the four key stakeholders of the growth company process are referred to as venture, V2C, capital, and government – as depicted in Figure 1 below (Jungman, Kankaala, Rasila & Seppä 2004).

- (i) VENTURE: entrepreneurs, ideally serial entrepreneurs, who invest all of their knowledge capital in a single venture for a given period of time
- (ii) V2C: venture knowledgists, who primarily invest knowledge capital, either on a professional (full-time) or hobby (part-time) basis in a limited number of ventures,
- (iii) CAPITAL: venture capitalists, who primarily invest financial capital, either on a professional (full-time) or hobby (part-time) basis in a limited number of ventures,
- (iv) GOVERNMENT: The policies and politics (fiscal, legal, structural, and cultural) that influence the dynamics of growth company process and resource market.

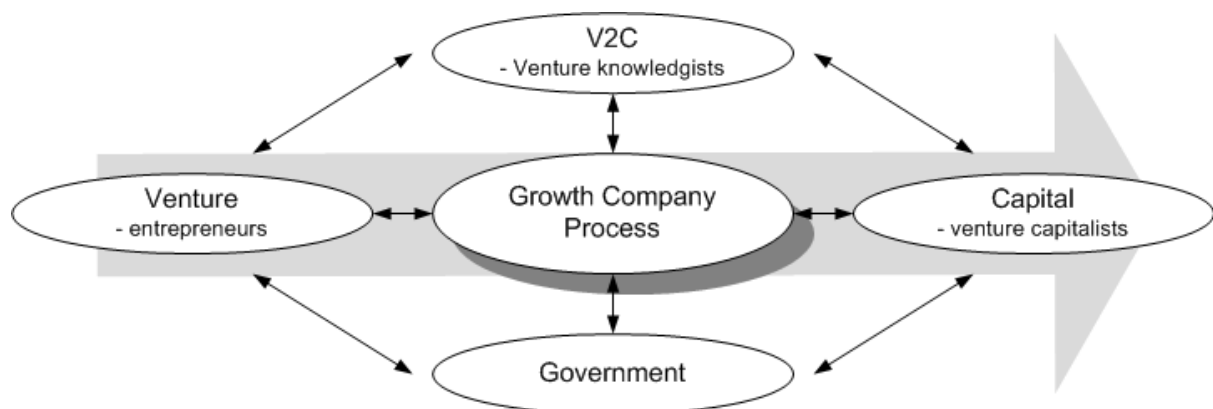


Figure 1. Stakeholders of the growth company process (Jungman, Kankaala, Rasila & Seppä 2004)

San José, Roure & Aernoudt (2005) argue that one of the biggest obstacles for individuals not getting involved in entrepreneurial process is the lack of understanding of the investment process and this prevents them taking advantage of the emerging investment opportunities. As a solution they propose a new form of invention, business angel academies. It can be assumed the situation to be similar in knowledge investing and this supports the need for new more formal model to channel knowledge capital into entrepreneurial ventures. One of the

main functions of this model should be support in investment process. This favours the need for professional management team similar to a venture capital management company.

It has also been argued, by Oakey (2003), that the key problem in early stage financing is the lack of commitment. Especially, this is the case in university spin-offs with long development lead-times. One side of the problem, as introduced earlier, is the shift in venture capital from hands-on to hands-off approach. This further verifies the need to develop a business model that from the beginning emphasises long term commitment.

All of the above shows that there is a need and opportunities in the early stage market for experimentation and new innovative structures. Further, existing success stories, like the structured business angel group to be introduced later, can be used as basis when creating new hybrid organisations. This paper reports seminal results from an ongoing study and introduces a structural proposition for the emerging V2C industry – a Knowledge Fund.

RESEARCH MISSION AND RESEARCH STRATEGY

The research underlying the present paper was triggered, in 2001, by observations of post-hype changes in VC investment activity and ambition to make scholarly sense of the phenomena at hand. Regardless of progress in conceptualisation and paradigm building, in the V2C space, the research is still primarily inductive and exploratory by nature.

The fledgling attempts, referred to above, are only the first efforts to conceptually define and establish the V2C phenomenon. Furthermore, the practical activity is still just as unorganised and heterogeneous as was the case with the VC industry 50 years ago or with business angel activity 25 years ago. (Seppä 2000; May 2002)

Research mission

The grand mission of the research underlying this study is to increase our understanding of the dynamics of creating successful growth companies as a partnership activity between entrepreneurs, knowledge investors, capital investors, and government. The business and strategy logic, and the interaction and dynamics of the different players and stakeholders of the V2C phenomenon are investigated, in order to build new conceptual foundations that bridge research on strategy, entrepreneurship, venture capital, and knowledge management.

At present, V2C players operate from a fragmented set of structures and offer no concept of industry to their key stakeholders. Based on existing wisdom on strategy logic of the venture capitalist, this conceptual paper provides a structural proposition for the emerging V2C industry. The primary mission, herein, is to share a social innovation, refine core concepts, and propose directions for empirical research in the V2C space.

The main research question, addressed in this paper, is the following: How could the V2C players utilise the limited partnership fund vehicle, the dominant VC industry structure, for the systematic channelling of knowledge investments to early stage ventures? As sub questions, we ponder upon: What would be the effects of the structural proposition to the key stakeholders of the V2C process, namely (i) entrepreneurs, (ii) venture knowledgists (and co-entrepreneurs), (iii) venture capitalists, and (iv) government?

Research strategy

Based on existing wisdom on strategy logic of the venture capitalist, the study seeks to design a business structure for the venture knowledgist: The concept of a Knowledge Fund. The study dives deep into the structural development of the limited-life limited-partnership based fund vehicle of the VC industry in its search for a structural proposition for the V2C industry.

The first task is to construct a guiding framework based on earlier VC and V2C research. Based on the basic understanding, a proposition for a Knowledge Fund is constructed for initial conceptual probing from the perspectives of the key stakeholders of the activity. The proposition will be a product of synthesis of existing literature constructed in the context of the empirical research phenomenon, embedded in the researchers' own role as active knowledge investors (or co-entrepreneurs) in early stage companies.

Importantly, the authors derive from their own efforts, as (part-time-based) practitioners, to design and set up a Knowledge Fund to bridge university based innovations and growth resources.

THEORETICAL FRAMEWORK

Over a short period of time, during 2001-2005, the V2C field has become defined as an emerging industry of ownership operators who, by bridging ventures (entrepreneurs) and capital (venture capitalists), build business aside of entrepreneurs. Thereby, the V2C players join a chain of active owners who build businesses from the entrepreneurial (foundation) stage to the public quotation.

These are market players whose business is to convert private equity to public equity and to earn profits by realising the value-added. This is a fragmented industry where one segment serves more the interest of the entrepreneurs, another the interest of the venture capitalists, and a third the interests of the government, and/or, in effect, their very own.

Normatively, the grand mission of the V2C industry is to align the interests of the parties. In particular, to align the interests of entrepreneurs and venture capitalists, whose matching has, to large extent, converted from the intimate partnership building of the good old days – due to bidding competitions, extensive due diligence procedures, etc. – to more sterile financial transactions.

In the view of this study, V2C, in particular, is an ownership profession, not a consulting, management or investment profession. Normatively, a V2C professional is closest to “professional entrepreneur” and, at the same time, very different from professional consultant, professional manager, and professional investor.

Since the seminal contributions by Tyebjee and Bruno (1981, 1984), Bygrave and Timmons (1984), and MacMillan, Siegel & Narasimha (1985), research on the growth company process has largely geared around the popular conceptualisation of the venture capital process, i.e., fund raising, entering, value adding, and exiting. The basic notion of the VC process underscores ownership, and its ability to reflect the value-added, as the primary

economic vehicle of building business from venture to capital. The classic role of venture capitalists has been to refine investable ventures listable in the eyes of the consumers of the stock market (investors in IPOs and parties to trade sales) generating profits from the margins of sale and purchase prices of equity stakes in portfolio companies.

The discovery and widely spread commercial application, since the late 1970s, of the limited-life limited partnership (LP) fund vehicle, in America, has significantly influenced the growth company process. The LP vehicle has proved to brilliantly serve the grand idea of the VC process: active temporary ownership of ambitious entrepreneurial ventures. The LP structure (i) enables those who (only) have financial capital to empower those who (only) have knowledge capital as independent venture capitalists (by granting them full “powers of attorney”), (ii) puts pressure on the empowered capitalists to act decisively, due to the limited life of the mandate, and (iii) creates significant incentives for the empowered capitalists to perform at the very best level, due to the carried interest element. (Seppä 2000)

In his study of the strategy logic of the venture capitalist, Seppä (2000) defines venture capitalism more as an ownership than a finance related phenomenon. He concludes, however, that VC is by no means a homogenous industry. Instead, he urges three fundamental questions to be addressed, when seeking to understand VC as a business (see Figure 2):

- (i) WHO is the venture capitalist (the true principal of the undertaking),
- (ii) WHY is he/she in business, and
- (iii) HOW is he/she (legally and structurally) organised.

Seppä (2000) finds six archetypes of strategy logic. In short, the archetypes are products of different combinations of answers to the three questions above: (i) The identity of the venture capitalist is classified either as entrepreneurial, corporate, or governmental; (ii) the missions either as direct financial or indirect strategic; and (iii) the structures either as single (one investment corporation) or a dual (management company – separate L.P. funds) structures. Consequently, the different archetypes put differing weights to the different phases of the VC process. One emphasises fund raising, another entering, a third value-adding, and – interestingly enough – only the normative one emphasises exiting.

In the present study, the normative archetype, referred to as Interim (or Professional) Owner, is assumed as the norm also for the V2C players. Hence, only entrepreneurial operators (not corporate or governmental) seeking for direct financial returns (instead of indirect strategic gains) via the dual structure (instead of the single corporation) are within the scope of this study. The five other archetypes are referred to as Asset Manager, Venture Banker, Empire Builder, Bounty Hunter and Caretaker.

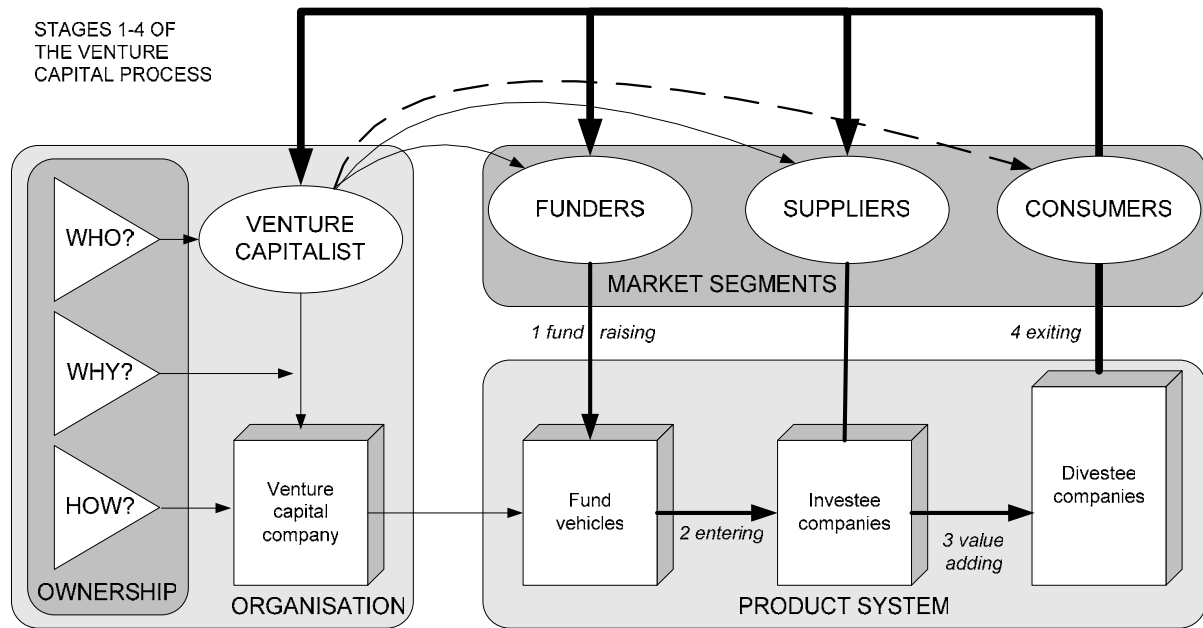


Figure 2. Strategy logic of the venture capitalist (Seppä 2000)

Besides the framework of venture capitalist strategy logic by Seppä (2000), the outline of the business concept of the normative V2C actor by Rasila (2004) is used as the underlying theoretical framework of the present study (see Figure 3). According to Rasila (2004), the investment fund should be complemented by a brain fund, or vice versa (for the first reference to a Knowledge Fund, in the context of the V2C phenomenon, see Seppä 2002).

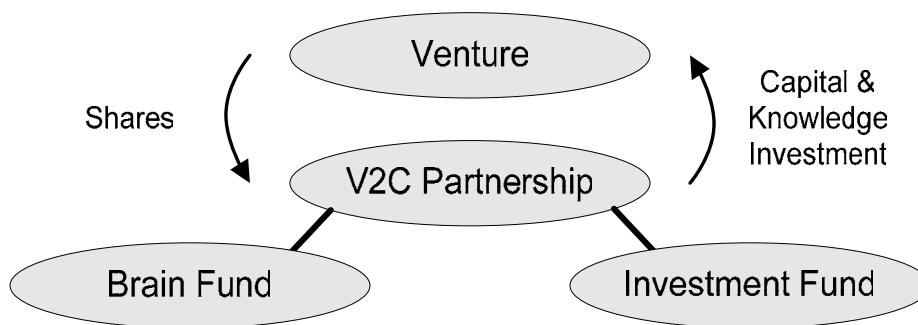


Figure 3. Outlining the business concept of the normative V2C actor (Rasila 2004)

In terms of defining the pool of V2C investors, the ongoing conceptual research by Rasila (2004) was used as key reference (see also Rasila et al. 2002). In general, V2C players fall into six categories: (i) business angels, (ii) incubators, (iii) advisors, (iv) corporate venturing schemes, (v) seed VC investors, and (vi) emerging V2C concepts.

The third framework for this study is the structured business angel group. For the best results also the angel investment process requires synchronisation of different components. The stakeholders involved are entrepreneurs, advisers, intermediaries and angels, all with different characteristics and personalities. An important factor for success is the management

of the whole investment process, including both entrepreneurial and interpersonal skills as well as the provision of capital. (San José et al. 2005)

In the centre of structured business angel groups is a knowledgeable manager identifying and screening the deal flow, managing the group, and discovering co- and follow-on investors. Typically, these structured groups are organised as limited liability companies (LLCs) where the individual angels are members and the leader or manager is the general partner. In addition to financial reward, the members also look for camaraderie and status. For example, Dinner Clubs process builds on monthly meetings where entrepreneurial teams – pre-screened by the manager – give their pitch followed by discussion and hand count voting for due diligence. If the consensus is clear yes, the meeting is followed by due diligence and a report by the team led by the manager. (May 2002)

In summary, we follow the strategy logic framework of the venture capitalist, crafted by Seppä (2000), which puts the emphasis on understanding the linkages between ownership of a venture capital company and its strategy logic. The framework depicts a product-market system comprising two primary types of products (funds and divestee companies) and three dominant types of markets (investors, entrepreneurs, and consumers of the stock market). The two other frameworks more close to the one to be depicted are the business concept of the normative V2C actor and structure of a structured business angel club.

KNOWLEDGE FUND DEPICTED

In our depiction, a team of growth venturing professional gets together driven by shared insights and values, and a joint vision for a defined window of opportunity: A deal flow of businesses where the founders are committed to building business from venture to capital – to rapidly building an entrepreneurial company from a growth prospect to investable (in the eyes of the venture capital industry) and, ultimately, to listable: From private equity to public equity. The synergy of the team may point at, e.g., a specific sector of economy or technology or a region or a stage of development. The window may be narrow and short as well as wide and long. The shorter and narrower the window, the faster the team needs to push for the opportunity.

The depicted model heavily stresses post-investment risk control over pre-investment risk control i.e. instead of exhausting due diligence the risks are controlled with active hands-on involvement in investee companies similar to business angels (see e.g. Van Osnabrugge 1999). Obviously this also emphasises the importance and quality of the knowledge investors' non-financial contribution, which, by definition, is seen more important than the financial contribution.

The structure of the Knowledge Fund is depicted below in Figure 4 and the stages of the investment process explained in some detail in the text below.

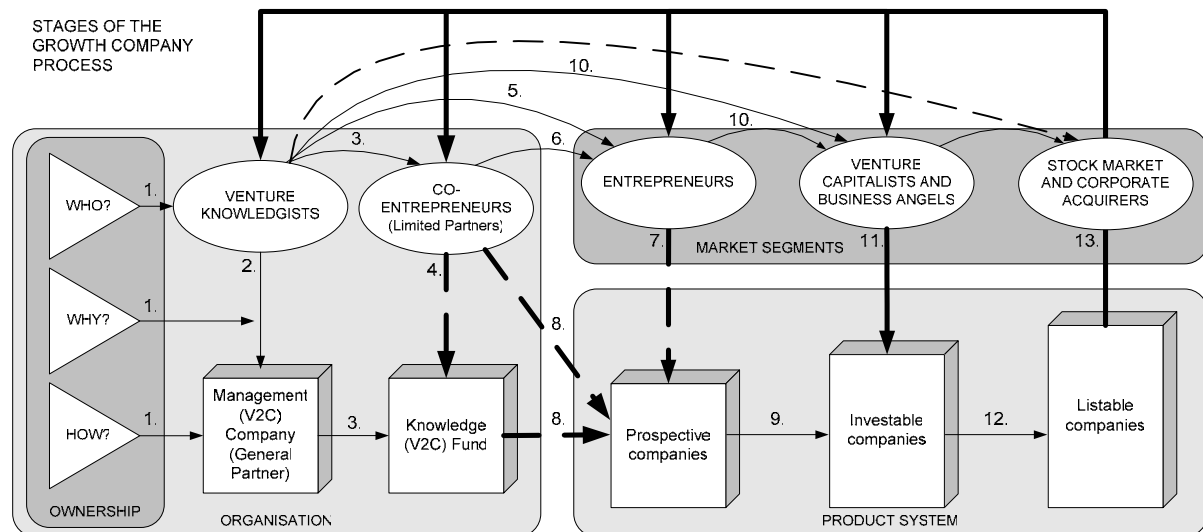


Figure 4. Knowledge Fund depicted

Fund Raising

The team decides to set up a Knowledge Fund – a pool of (mainly) part-time based knowledge investors relevant and sufficient with regard to the window of opportunity at hand.

1. Individual growth venturing professionals discover the potential of their combined (i) venture deal flow and (ii) associated brain pools (networks of prospective knowledge investors)
2. Entrepreneurial initiative is taken to formally establish a VC2 partnership – typically a limited liability firm – giving birth to new professional venture knowledgeable
3. Fund raising is commenced by offering LP stakes in the limited-life vehicle to members of the combined brain pool (the venture knowledgeable’s pool of knowledge investors) by the venture knowledgeable and their company serving as general partners
4. Commitment of knowledge investments to the Knowledge Fund by the members of the combined brain pool – giving birth to a new V2C industry structure and a group of professionals referred to as co-entrepreneurs (the limited partners)

Entering

In the concept, the individual venture knowledgeable, co-entrepreneurs, and portfolio entrepreneurs, comprise the key sources of deal flow.

5. Connection with a prospective entrepreneur and the venture takes place
6. Common interest, insights, values, and vision are established, and individual co-entrepreneurs selected from Knowledge Fund by venture knowledgeable for knowledge investment discussion with the entrepreneur, and the venture knowledgeable
7. Final deal negotiations are undertaken between the three parties, and the formation of the new ownership base completed by having the individual roles of each party, as well as a joint agenda established

Value adding

In the concept, value is built by a value network composed by the entrepreneur, the venture knowledgist, the selected co-entrepreneurs, and – later on – by the venture capitalist. Together the four parties build target company value for the benefit of the consumers of the stock market – either investors in an eventual IPO of the target company or the acquirer in an intervening trade sale situation.

8. Ownership arrangements are executed; the Knowledge Fund becomes a new shareholder in the prospective venture, aside of selected few co-entrepreneurs – and the set-up of the new governance structure serves as the first element of value-adding
9. Value adding from prospective to investable phase commences
10. Connection between the venture, the venture knowledgist and a venture capitalist
11. Entry of venture capitalists (further expansion of ownership base); only partial, reasonable exit of the venture knowledgist and co-entrepreneurs materialises
12. Value adding from investable to listable phase commences; at this stage of the process, the VC takes over as the coach of the target organisation – grooming it towards public quotation.

Exiting

In the concept, the ultimate profiting and revenue generation of each of the parties, in the value network, is tied to the final exit. Thereby, the introduction of the Knowledge Fund concept is largely aimed at bringing the interests of the entrepreneurs and the venture capitalists in full alignment.

13. Successful joint sale of equity by the entrepreneur, the V2C operators, and the VC players to consumers of the stock market (either following an IPO or a trade sale to an already quoted industrial acquirer) in an exit arrangement, complete the growth company process and fulfil the profiting interests of the key parties (partners).

There are several important issues to be addressed or covered, with regard to cash flows, target venture valuations, and profit sharing schemes. All issues, on the other hand, that different operators may choose to solve with differing principles, thereby contributing to differences in competitive positions and, at best, accruing competitive advantages.

STAKEHOLDER PERSPECTIVES

There are four main stakeholder groups to the Knowledge Fund, namely the entrepreneurs, the venture knowledgists and co-entrepreneurs, the venture capitalists, and the government. These stakeholders have also been identified as the most important ones when analysing the performance of V2C actors (Jungman, Okkonen, Rasila & Seppä 2004). Of these stakeholders entrepreneurs are the first customer group or market segment to be interacted with, but the ultimate customers are the consumers on stock markets and corporate acquirers – venture capitalists fall in between. The products offered are knowledge capital for prospective companies, investable companies for venture capitalists, and listable companies for the final customers. As distinction to the venture capitalists strategy logic, co-entrepreneurs i.e. (knowledge) investors and the fund vehicle are seen to be within the organisation. Next, we shall analyse the operation of the Knowledge Fund from each of the stakeholders' perspective.

Entrepreneur

To the entrepreneur, the Knowledge Fund represents a systematic pooling and channelling of the scarce, secretive, and intimate resources that are vitally critical to new venture success. The Knowledge Fund catalyses the birth of a new profession and industry, an industry of co-entrepreneurs and venture knowledgists that serve as a sort of extension of the classically lonely role of the entrepreneur.

The entrepreneur should make certain that there is chemistry between the venture knowledgists, to begin with, as well as with each of the selected co-entrepreneurs. Also, there should be detailed discussions between the three parties as to what is expected from each player.

Venture knowledgist and co-entrepreneur

The Knowledge Fund is primarily the vehicle of the venture knowledgist. Hence, the venture knowledgist has the greatest responsibility of the functioning of the structure. Whereas the Knowledge Fund marks a profession (full time business and livelihood) to the venture knowledgist, it marks a hobby to the co-entrepreneurs. Nevertheless, the Knowledge Fund represents an important element of risk sharing and professional development also to the co-entrepreneurs.

The venture knowledgist, in order to solve the day-to-day financing problems, needs to raise each Knowledge Fund with such financial commitments that cover for reasonable management costs. Three partners combined require an absolute minimum of 300.000 euros per year for management expenditures, including modest salaries, in most parts of Europe. To survive in operation for ten years, the financial commitments of the limited partners (co-entrepreneurs) should be, in total, at least 3 million euros. A Knowledge Fund targeting a total of 30 limited partners (co-entrepreneurs), should seek commitments – besides their knowledge capacity – in cash also, at least 100.000 euros from each. Given the picture, both the venture knowledgists and the co-entrepreneurs – and the whole idea of the Knowledge Fund – would greatly benefit from the participation of separate financial investors. For any financial investor, 3 million euros is peanuts. For most knowledge investors, 100.000 euros is a lot.

Venture capitalist

To the venture capitalist the Knowledge Fund bears the promise of improved deal flow and ability to enter prospective ventures earlier than would be the case without such members of the relay team of building business from venture to capital. The venture capitalist should embrace the independence of the venture knowledgist and resist temptation to control (even own) this player, in order to support the dynamism of the market.

The venture capitalist should appreciate the venture knowledgist's confidence in the venture capital process – i.e., the leading role of the VC in realising the ultimate capital gains in an exit arrangement – by allowing a partial exit to the V2C player upon entry of the VC. A partial exit would serve two purposes: (i) payment for work done and role completed and (ii) prevent dilution of the founding entrepreneur or who ever is to be raised in top managerial positions for the final stretches before an envisioned IPO.

Government

For the government, the concept of the Knowledge Fund represents potential for a new delivery channel of growth resources. As according to Rasila (2004), a certain combination of investment fund and Knowledge Fund (or brain pool) is required to cover for the day-to-day costs of the venture knowledgists. The fact that the venture knowledgists serve distinct groups of co-entrepreneurs serves as insurance to a necessary financial investor, which role could well be suited to governments whose market environments are insufficient in the V2C space, such as is the case with Europe and, in particular, Finland.

The government could not, by definition, as a venture capitalist, offer anything but financial investment. Any hands-on involvement would come from agents of the government – either officers on payroll or assigned consultants. Such individuals would be difficult to motivate to invest businessman wisdom (or entrepreneurial capacity) into their portfolio companies. Instead, the Knowledge Fund offers a perfect possibility to co-invest financial capital along entrepreneurially invested knowledge capital.

In conclusion, the value adding chain – or the value network – of the growth company process can be depicted as follows (see Figure 5). The depiction underscores the importance of responsibility and commitment of owner operators – which should be supported by government policies, financing programs, and incentive schemes – in building business from venture to capital.

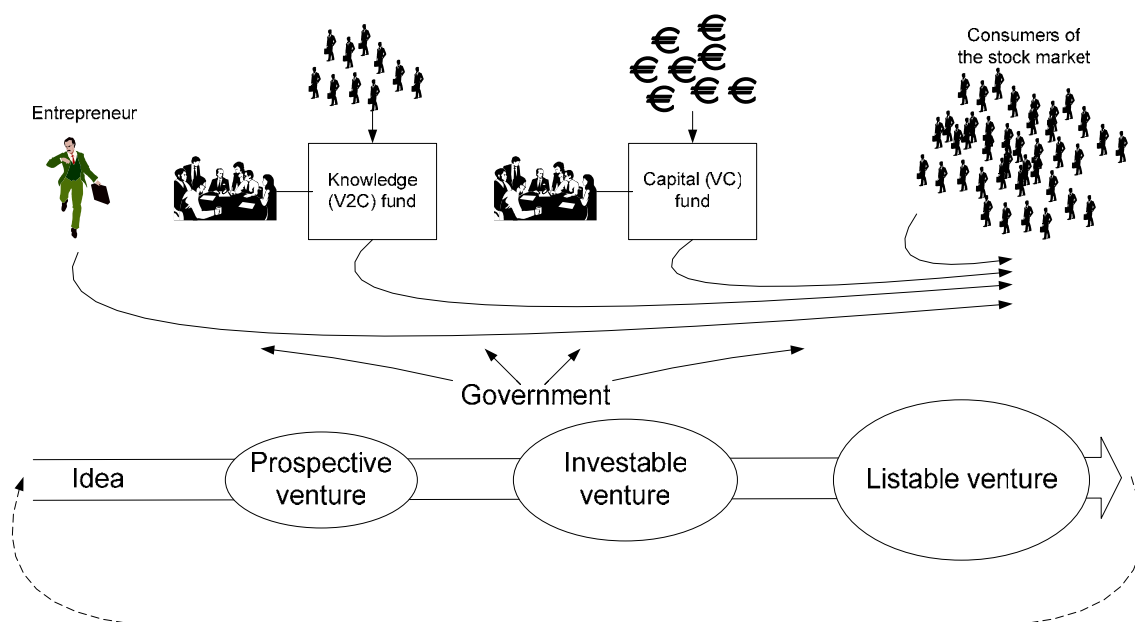


Figure 5. The value adding chain of the growth company process

DISCUSSION AND CONCLUSIONS

Ventures faced with the knowledge gap (or the business wisdom gap) have the problem that the knowledge they need cannot be bought on the market in the classic meaning of the word.

On the other hand, such ventures would only in rare case have the financial means, to begin with.

Hence, in the acquisition of such knowledge, expansion of owner base may be a working solution. Creative, professionally managed structures that encourage interim ownership participation by relevant representatives of the different sectors of the society – business, university, and government – could be the missing link between venture and capital in the growth company process. Needless to say, completion of the value chain between venture and capital would have a significant impact on the economy at large. Naturally, such a crossing of borders and boundaries would require a wide discussion and acceptance – and appreciation – across the entire society.

After an era centred on venture capitalists, as the key providers of external growth resources to entrepreneurs and the private enterprises, venture knowledgists appear to be emerging as the newest rain maker and the enabler of economy in the 21st century.

With the general rise of ICT enabled – and enforced – business models and concepts and, consequently, the transformation from value chains to value networks, and from capital intensive to knowledge intensive new venture activity, the most critical role in an economy, referred to above, may be shifting from those who invest (financial) capital to those who invest knowledge in ambitious entrepreneurial ventures to build them investable in the eyes of the financial investors. In the language of this study: In the knowledge society, the role of the key enabler of economy is shifting from VC to V2C.

Borrowing and amending the classic words of Brophy (1986): It is unlikely that a country or a region can be competitive without a dynamic and vibrant V2C community. By deciding, on behalf of the society at large, which new ventures are to go forward and which not, knowledge capital investors – such as venture knowledgists via Knowledge Funds – will play the almost godly role in an economy which classically has belonged to financial capital investors: First to Kings and Kaisers, then bankers and industrialists and, finally, throughout the Cold War era, to venture capitalists.

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