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EFFICIENCY OF REGIONAL V2C STRATEGY: CASE TAMPERE

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ABSTRACT

Growth in the supply of venture capital financing, from one hand, and growth in the supply of ventures seeking for financing, from the other hand, have yielded a paradox. While there for once is no shortage of capital, there is a shortage of small enough doses of it. Thanks to the ICT era, new venture activity is transforming from capital to knowledge (hands-on) intensive. As a result, regions are faced with a challenge of how to facilitate for the matching of ventures and capital. While the consumption of public funds to venture-to-capital or V2C activity is ever more easily justified, also quests for the efficiency of local V2C strategies are increasingly relevant. In the view of this study, there are four key stakeholders to the V2C process: The entrepreneurs, V2C players, venture capitalists, and the government. This study examines efficiency of the city of Tampere, Finland, V2C strategy, by surveying the perceived value-added of the entrepreneurs in the portfolio companies of the city sponsored V2C players.

1 INTRODUCTION

1.1 Equity and Knowledge Gaps

During the past decade both the amount of venture capital financing and the number of new ventures seeking for financing have soared. The paradox is that ventures and capital do not meet. While the average size of venture capital funds and, hence, the size of a minimum investment have grown exponentially, ventures and business in general have transformed from capital intensive to increasingly knowledge (hands-on) intensive. Together, these phenomena have accelerated the emergence of equity and knowledge gaps between new venture activity and the venture capital industry. This development has given rise to new kind of business development agents, referred to, herein, as Venture-to-Capital or V2C actors, whose objective is to bridge these gaps by pushing ventures from ‘prospective’ to ‘investable’ in the eyes of venture capitalist. (Rasila et al. 2002) (See Figure 1.)

As said, the common nominator of the V2C actors is that they refine entrepreneurial ventures ‘investable’ to fulfil the investment criteria of venture capital industry. These actors can be divided into five groups: advisors, business angels, corporate venturing units, incubators and emerging V2C actors. The representatives of the fifth group – emerging models – do not fit into the four specific categories, but do often comprise best practices from them. This categorisation is based on our earlier work on the V2C phenomenon. (For more comprehensive taxonomy, see e.g. Rasila 2003.)

The study at hand is part of a larger ongoing research, development and education program, the goal of which is to increase our understanding of the dynamics of V2C activity. According to the vision behind the research program, V2C players have assumed (a part of) the classic role of the venture capital industry. The argument can be grounded in David Brophy's (1986) classic discussion on the role of the venture capital financier (modified below to the V2C context):

> "To put the role of [V2C] in context, it is useful to think of it as a key part of the economic growth process now facing the United States and other countries as well. The [V2C] process is important in marshalling resources for the attainment of benefits for government, business, and the public at large… It is… to the point to think of the [V2C] financier as the overseer of the market exchange system, in a sense deciding through financing decisions, on behalf of society at large, which new projects should go forward and which should not. This is an important function in the economic transition now facing many economies. It is unlikely that a country or area can be competitive in commercial exploitation of innovative process, products, and services without a strong local [V2C] community."

Economically, V2C activity clearly plays a significant role in the value chain of the venture capital industry as a pre-screener of ventures and provider of knowledge and capital for the most 'prospective' ones, the ones with most potential as investment targets of the venture capital industry. Furthermore, this activity will speed up the growth of new companies and therefore increase the pace of job creation. And as lent from Brophy (1986), V2C players will decide, "as the overseers of the market exchange system, on behalf of society at large, which new projects (businesses) should go forward and which should not."

1.2 The V2C Strategy of the city of Tampere

While the city of Tampere has 200.000 inhabitants, a good 300.000 people live within a 20-minute-drive from the city centre, and a half a million within a radius of 100km. With help of two universities (Tampere University of Technology and University of Tampere), other institutions of higher education and research, and a number of knowledge centres and science parks, the Tampere region is rapidly emerging among the most recognised local knowledge areas in Europe. One of the drivers of this development, the eTampere knowledge society development program, is largely geared at putting eEurope – the vision of Europe – into action on a local level.

The goal of the eTampere program is no less ambitious than to make Tampere the world's leading local knowledge society. One mean to achieve this target is creation of new businesses, acceleration of their growth and development. According to the business development strategy of the city of Tampere, this activity is supported by providing help in set-up activities and in evaluation of business ideas, creating culture that encourages entrepreneurship, securing appropriate finance, helping to get required working premises, and promoting networks. This is reflected in the business development strategy of the city of Tampere (Tampereen elinkeinostrategia 2002).

The city of Tampere has been active as key financier and part owner in developing specialised incubators and has a portfolio of four sector specific V2C actors: Finn-Medi Research (health technology), Tampere Technology Centre/Hermia Business Development (ICT), Media Tampere (digital content) and Professia (KIBS). Each of the four publicly funded players has a specialised incubator. Professia manages of also Media Tampere's incubator (Media Club). The mission of the players is to turn 'prospective' ventures 'investable' in the eyes of venture capitalist, i.e., to help ventures cross the dual gap. The city of Tampere has also invested in venture capital funds especially targeted to finance early stage companies. Furthermore, there are several other active V2C players in the region, including business angels, advisors, seed venture capitalists and some new innovative V2C operating models. Finnish Business Angel Association was, in fact, established in Tampere in 1997. However, in terms of the magnitude of angel investing, Tampere is by no means a leading city in Finland.

1.3 Research Topic

The dynamism of the local V2C market plays a central role to the functioning of a regional innovation system and to the creation of new businesses. This study focuses on Tampere, number two urban region in Finland, with the objective of

> *examining the relative efficiency of the city of Tampere portfolio of V2C actors in satisfying entrepreneurial expectations and needs.*

Herein, effectiveness relates especially to perceived value-added – more specifically accessibility and fulfilment of needs – from the point of view of growth-oriented entrepreneurs. Without question, this is an important measure of effectiveness and value-added, but, in our view, only one of four critical perspectives. The V2C actors are seen as one of four key stakeholders of a value network accelerating the growth company process. Herein, the city of Tampere is seen as a governmental player facilitating for the four V2C actors. (See Figure 2.)

The V2C phenomenon as a whole has not been under any great research attention, at least in Finland. For an example of earlier work conducted in Finland, see Mäki and Sinervo (2001) on the role of science parks in Finland. Their research also looks at the role of business incubators located in the science parks. For a yet earlier example on research on business angel activity in Finland, see Suomi and Lumme (1994).

In this study, value-added refers to all non-financial benefits the portfolio companies receive from their V2C partner. Research on value adding by V2C actors is scarce. Harrison and Mason (1992) suggest that formal venture capital investors (venture capitalists) tend to put more emphasis on control function than informal venture capital investors (business angels). This finding is further supported by their later research (Mason and Harrison 2000) concluding that business angels “contribute their commercial skills, entrepreneurial experience, business know-how and contacts through a variety of hands-on roles to make a wide range of strategic, monitoring and supportive inputs.” According to Ardichvili et al. (2000), business angels help ventures shape business concepts, assist them in finding additional sources of capital, recruit key personnel, assist in the development of strategy, and play active roles in the post-investment governance of the firms. A recent study on business incubators suggests that, in addition to office space, they should provide hands-on services such as managerial assistance, access to finance, legal advise, operational know-how and access to new markets (Aernoudt 2002). Seidel (2001) demonstrates that business incubators add value in four ways: 1) value of the incubator network (who), 2) value of gaining CEO expertise within the incubator (how), 3) value of regular feedback (how well), and 4) value of incubation affiliation (why). Seidel’s study (2001) was conducted by interviewing six CEOs or founders whose companies were being incubated in a given business incubator.

The city of Tampere has an active V2C strategy. The present study was aimed at examining how efficiently its implementation fulfils the needs of the entrepreneurs.

2 RESEARCH STRATEGY AND DATA

Basic information on the business of the local V2C actors was generated via public data sources. A more in-depth understanding of their roles in the Tampere business development strategy was established via semi-structured interviews of the key individuals of the local V2C arena, including the CEOs of the four V2C players. Thereafter, a web based survey study was conducted targeting the entire portfolio company population of the four V2C actors. The questionnaire (see Appendix 1) was developed based on earlier work in the V2C research program (Jungman et al. 2004). The framework emphasises a V2C actor’s role of delineating ventures ‘from prospective to investable’ through the V2C actor’s influence on profitability, revenue growth, and potential to raise venture capital financing.

Similar questionnaires have been harnessed to study the venture capital industry. Typically, such studies concentrate on the value-adding roles of different outside owner-partners, for example, venture capitalists and business angels. (See e.g. Gorman and Sahlman 1989, Harrison and Mason 1992, Seppä 2000). The quest for value-adding roles is geared around the concept of the venture capital process, classically divided into four phases: Fund raising, entering, value adding, and exiting (for a seminal exposition of the venture capital process, see Tyebjee and Bruno 1981). In addition to value-adding studies, the framework developed for the present study utilises aspects associated with analysing the entering phase, as well as the various uses of ownership-related instruments in acquiring outside expertise into the growth company process. Ultimately, the study comprises five sets of questions: 1) Background information, 2) Availability of V2C services, 3) Value adding, 4) Ownership, and 5) Overall satisfaction. In addition, an open field was offered to the respondents for any general comments on the efficiency of V2C activity in Tampere.

In November 2003, a questionnaire was sent to a total pool of 38 CEOs via the four V2C actors. Based on our general depiction of the scope of the activity of the four actors, we expected a larger V2C portfolio company population for the city of Tampere sponsored incubators and, hence, consider this finding a first research result worth further examination. In total, 17 companies responded to the survey, resulting in a response rate of 45% (see Table 1 for a break-down of the population and respondents). While 45% is not a poor result, per se, our aim was at a much higher representation of the population, given its surprisingly small size. Also, disperse of response rates between the incubators was significant.

The average age of the respondent companies was 28 months. The oldest was established in 1995, while a majority of the respondent firms were established in 2001 or later. Of the respondent firms, 47% had 1-2 full time employees, 24% had 3-5, and 18% had 6-10 employees. The remaining 12% of the companies had no full time employees. Eight of the 17 respondent companies had been clients to a city of Tampere V2C actor for less than a year, another eight for 1-2 years, and one company for 3-5 years. Of the respondent firms, 59% defined the primary nature of their association with the V2C player as “incubator services”, 35% as “business plan creation”, and 6% as “business idea evaluation”.

Overall, given the small sample, no rigorous statistical analysis was performed on the data. In fact, even cross-tabulations were sparingly employed.

3 RESULTS

3.1 Accessibility of V2C services

Table 2 summarises the results from the questions related to the accessibility of V2C actors. These results clearly indicate that information about the V2C actors is easily available and the actors are also relatively easy to approach. However, there was some dispersion in answers regarding the ease of choice between V2C actors. Even though information about the V2C actors is easily available, the information appears to be rather general in order to make a difference between them. The respondents called for more specific and centralised information on the V2C services, for example, through a joint web site or portal. Especially, there appears to be a need to more clearly communicate what kind of services these actors really provide. One vehicle suggested by a respondent was the use of reference case stories.

3.2 Value-added

The respondents were asked to rate a V2C actor’s three most important value-adding elements from a list of ten alternatives (see Table 3). The forms of value adding rated the most important were strategy and business skills (by 29%), premises and clerical skills (by 24%), and contacts and networking skills (by 18%). To the V2C actors’ credit, these value-adding elements also received the highest ratings. However, the overall rating was not particularly high; the average ratings varying from 6.9 to 8.3 on a scale from 4-10. A particularly low rating was placed on networking within the incubators. The respondents were asked to rate their V2C actor regarding the extent of networking among the portfolio companies. The average rating was 5.8. It is worth noting already here that none of companies had received equity investments from their V2C actors – a typical feature of public sector incubators in Finland.

Another noteworthy point, related to value adding, is that V2C actors, by definition, are to refine 'prospective' ventures 'investable' in the eyes of venture capital industry. To evaluate this role of V2C actors the entrepreneurs were asked to estimate the influence of V2C actor into profitability, revenue growth and potential of raising venture capital financing. The results are summaries in Table 4. Reportedly, in most cases, profitability and revenue growth had increased while in a V2C portfolio. On the same token, no significant increase in potential of raising venture capital financing was reported. The overall influence of the V2C actors to these three key deliverables was evaluated by each of the respondents as positive or neutral.

According to the respondents, V2C actors can further develop their value adding via selection of right personnel, by being more focused in what services they really offer – "not just knowing everything" but by providing active coaching to fresh entrepreneurs "to whom everything is new and amazing" and by providing more hand-holding and support during the first steps.

3.3 Ownership

According to the basic thrust of the V2C research program, more efficient and appropriate distribution and use of target venture ownership could be a key to more successful V2C activity. In fact, ownership – not financing – is key to both venture capital and V2C activity (for a seminal study on venture capital as ownership rather than financing related activity, see Seppä 2000). In particular, ownership could be used as a vehicle to acquire crucial knowledge – such as businessman wisdom and competence to mobilise resources – to target ventures. As such knowledge cannot be bought on the market in the classic meaning of the word, expansion of owner base may be a working solution. In return for their role as 'co-entrepreneurs' – the businessman wisdom they are willing to invest in their portfolio companies – V2C players could receive a minority ownership stake in a given target company. The general pool of knowledge investors includes fellow entrepreneurs, various adviser communities, university scholars, and business executives.

When presented the idea, only two of the respondent firms would reportedly refuse to consider such knowledge (or businessman wisdom) investment from an outside source. In fact, four respondents had been offered such an opportunity. Furthermore, 88% of the respondent firms would welcome an increase in the supply of such activity. It is worth noting that the respondent companies had little exposure to outside governance. For example, only four of the companies reported that they have outside members of the board.

3.4 Overall satisfaction

To summarise, the city of Tampere V2C actors received an average grade of 7.4 (on a scale from 4-10) for an overall rating of the efficiency of the V2C player. Of the respondents, as many as 71% would recommend their V2C actor to other entrepreneurs, with the remaining 29% willing to at least consider recommending. Moreover, a third of the respondents strongly agreed, and altogether 82% agreed that it had been a good choice to enter into the V2C actor's portfolio and that the support, help, and involvement had been in line with their expectations (see Table 5).

Hence, there is reason to conclude that the regional V2C strategy of the city of Tampere has been efficient, in general, when it comes to the viewpoint of the entrepreneurs responded. Interestingly enough, however, 29% of the respondent firms gave a higher overall valuation to a V2C player other than their city of Tampere V2C incubator.

4 DISCUSSION AND IMPLICATIONS

Due to the limited sample, the findings of this study cannot be generalised. However, it yields a number of valuable observations and food for thought. Also, we believe that the study offers a valid, although neither thoroughly representative nor comprehensive depiction of V2C activity in Tampere region.

The population of V2C portfolio companies became defined smaller than expected. Further work needs to be conducted to examine the reliability of this basic assumption in order to tackle any potential bias in the sample. For the purpose of the present study, the definition of the total population was based on the announcements of the V2C players themselves and no controls were employed on the reported figures.

Regardless of some signals supporting a positive view of overall efficiency, we believe that the V2C activity could be yet more effective. One significant proposition for a direction of development is increased co-operation between the V2C actors. The cooperation could be initiated, for example, in a form of a centrally maintained web directory of the V2C services in the area. Another important direction pointed by the findings of this study is the expressed need to increase networking among the portfolio companies.

On a more critical tone, there are testimonials that the V2C players could put more attention to being partners with their portfolio ventures. In the words of one of the respondents:

> "V2C actors should take care of our business instead of using us as the means of taking care of their business. Sometimes we get relevant information from them, but it is occasional."

Another prospective avenue to increase the V2C player's incentive in working with their ventures, and hence the general efficiency of V2C activity, comprises innovative uses of ownership as the vehicle of knowledge (or businessman wisdom) transfer. The study finds support for an increased supply of knowledge investment activity.

Further research should examine the perceived value-added of the other stakeholders of the growth company process. Also, it is important to look beyond perceptions: To compare actual inputs and outputs, both physical and mental, both financial and strategic, when measuring and evaluating actual efficiency of V2C activity in any local, national, or international setting.

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ILLUSTRATIONS

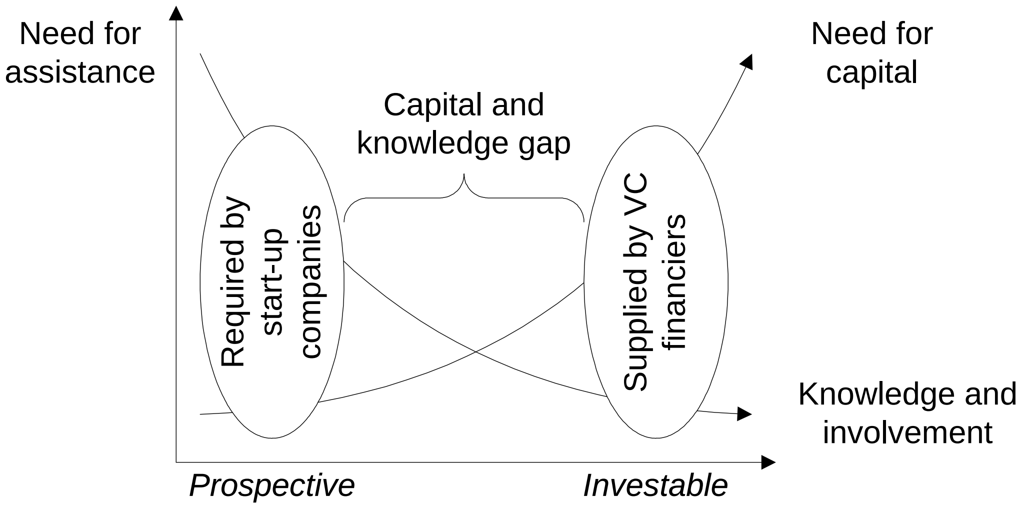

Figure 1. Equity and knowledge gaps (Rasila et al. 2002)

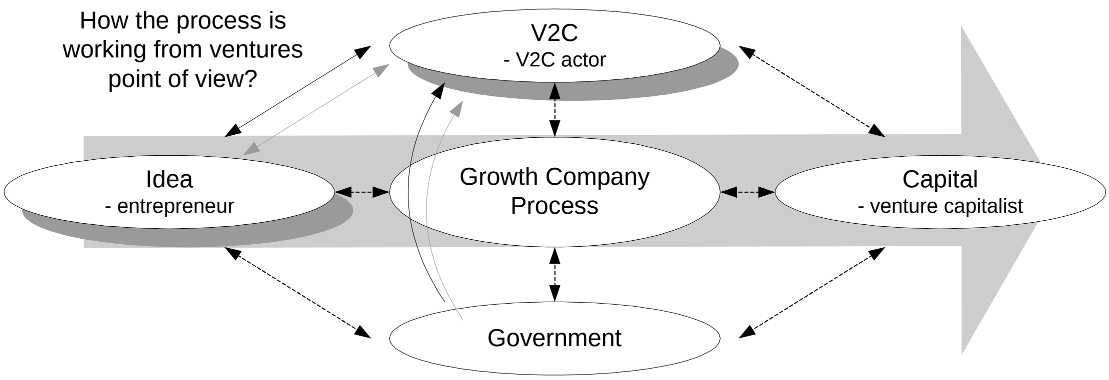

Figure 2. Research framework

Table 1. Breakdown of the population and respondents

	Population	Respondents	Response rate
Finn-Medi Research	12	4	33%
Hermia Business Development	13	1	8%
Media Tampere	3	3	100%
Professia	10	9	90%
Total	38	17	45%

Table 2. Accessibility of V2C services

	1	2	3	4	5
a) Information about V2C actors is easily available	0.00%	17.65%	41.18%	41.18%	0.00%
b) V2C actors are easy to approach	0.00%	23.53%	11.76%	47.06%	17.65%
c) It was easy to choose between the V2C actors	11.76%	17.65%	35.29%	17.65%	17.65%
d) I missed better assortment of V2C actors	23.53%	17.65%	29.41%	0.00%	29.41%

1 = Strongly disagree … 5 = Strongly agree

Table 3. Value adding skills

	Rate	Most important	Second important	Third important
a) Human resource management skills	7.19	0.00%	0.00%	5.88%
b) Contacts and networking skills	7.35	17.65%	11.76%	23.53%
c) Sales and marketing skills	7.12	11.76%	5.88%	0.00%
d) Financing skills	7.71	5.88%	35.29%	11.76%
e) Strategy and business skills	7.75	29.41%	29.41%	0.00%
f) Financial management skills	7.50	0.00%	0.00%	17.65%
g) Premises and clerical services	8.25	23.53%	5.88%	11.76%
h) Manufacturing and product development skills	6.93	5.88%	0.00%	5.88%
i) Taxation and juridical skills	7.06	0.00%	0.00%	11.76%
j) Entrepreneurial partnership (coaching)	7.36	5.88%	5.88%	5.88%

Each of the value adding skills were rated with grading scale 4 (worst) – 10 (best)

Table 4. Development of profitability, revenue growth and possibilities of raising venture capital financing

	Development during the V2C customership			Influence of the V2C actor		
	+	+ -	-	+	+ -	-
a) Profitability	50.00%	37.50%	12.50%	25.00%	75.00%	0.00%
b) Revenue growth	62.50%	31.25%	6.25%	31.25%	68.75%	0.00%
c) Possibilities of raising venture capital financing	33.33%	66.67%	0.00%	35.29%	64.71%	0.00%

Table 5. Overall satisfaction

	1	2	3	4	5
a) It has been a good choice to have a customership with the V2C actor	0.00%	0.00%	17.65%	47.06%	35.29%
b) The support, help, and involvement got from V2C actor has been in line with expectations	0.00%	5.88%	29.41%	47.06%	17.65%

1 = Strongly disagree … 5 = Strongly agree

APPENDIX 1

Survey to the V2C actors' customer companies

This survey maps the state of V2C activity (success and efficiency) from the point of view of customer companies in the region of Tampere. All answers will be kept private. Individual answers will not be reported and neither will unique type of reference delivered to V2C actors.

V2C actor refers, in here, to different kind of developers, advisors and financiers that are involved in the early stages of a company before it's 'investable' in the eyes of venture capitalists. These actors include e.g. business incubators and business angels.

1. Background Information

a. Year of foundation
   - _ 1994 or earlier
   - _ 1995
   - _ 1996
   - _ 1997
   - _ 1998
   - _ 1999
   - _ 2000
   - _ 2001
   - _ 2002
   - _ 2003

b. Month of foundation
   - _ 01
   - _ 02
   - _ 03
   - _ 04
   - _ 05
   - _ 06
   - _ 07
   - _ 08
   - _ 09
   - _ 10
   - _ 11
   - _ 12

c. Place of residence

   ____

d. Industry

   ____

e. Number of full-time employees
   - _ None
   - _ 1 – 2
   - _ 3 – 5
   - _ 6 – 10
   - _ Over 10

f. With which of the city of Tampere's V2C actor the company has a customership?
   - _ Finn-Medi Research
   - _ Hermia Business Development
   - _ Media Club
   - _ Professia

g. The number of V2C actors involved in the company
   - _ 1
   - _ 2
   - _ 3 or more

h. The length of customership
   - _ Under 1 year
   - _ 1 – 2 years
   - _ 3 – 5 years
   - _ Over 5 years

i. The most valuable V2C actor has been
   - _ The one mentioned above (plank f)
   - _ Business Angel
   - _ Advisor
   - _ Seed venture capitalist
   - _ Other

j. The customership with most significant V2C actor is
   - _ Business idea evaluation
   - _ Business plan creation
   - _ Incubation services
   - _ Responsible ownership

2. Accessibility of V2C actors

a. Rate the following matters with scale 1 – 5 (1 = Strongly disagree … 5 = Strongly agree)
   - _ Information about V2C actors is easily available
   - _ V2C actors are easy to approach
   - _ It was easy to choose between the V2C actors
   - _ I missed better assortment of V2C actors

b. How could the matters mentioned above be developed?

____

____

____

3. **Value-added provided by V2C actors**
(Answer according to plank 1.f unless otherwise mentioned)
   a. Rate the following V2C actor's skills with grading scale 4 – 10 (4 = Worst … 10 = Best)
      _ Human resource management skills
      _ Contacts and networking skills
      _ Sales and marketing skills
      _ Financing skills
      _ Strategy and business skills
      _ Financial management skills
      _ Premises and clerical services
      _ Manufacturing and product development skills
      _ Taxation and juridical skills
      _ Entrepreneurial partnership (coaching)
   b. Which of the following are the three most important forms of value adding provided by V2C actor (despite the grades given above)? (Mark 1 for most important, 2 for second important, 3 for third important)
      _ Human resource management skills
      _ Contacts and networking skills
      _ Sales and marketing skills
      _ Financing skills
      _ Strategy and business skills
      _ Financial management skills
      _ Premises and clerical services
      _ Manufacturing and product development skills
      _ Taxation and juridical skills
      _ Entrepreneurial partnership (coaching)
      _ Other ____________________
      _ Other ____________________
      _ Other ____________________
   c. How has the profitability of the company developed during the time of V2C customership?
      _ Got better
      _ Remained unchanged
      _ Got worse
   d. What has the influence of V2C actor to the profitability been like?
      _ Positive
      _ Neutral
      _ Negative
   e. How has the revenue growth of the company developed during the time of V2C customership?
      _ Sped up
      _ Remained unchanged
      _ Slowed down
   f. What has the influence of V2C actor to the revenue growth been like?
      _ Positive
      _ Neutral
      _ Negative
   g. How have the company's possibilities of getting venture capital financing developed during the time of V2C customership?
      _ Got better
      _ Remained unchanged
      _ Got worse
   h. What has the influence of V2C actor to the possibilities of raising venture capital financing been like?
      _ Positive
      _ Neutral
      _ Negative
   i. Total amount of capital invested by V2C actors
      ____
   j. Number of outside members in the board of directors
      _ None
      _ 1
      _ 2
      _ 3 or more
      _ I can't say
   k. Number of V2C representatives in the board of directors
      _ None
      _ 1
      _ 2
      _ 3 or more
      _ I can't say
   l. How often do the company and the V2C actor interact?
      _ Daily
      _ Several times in a week
      _ Weekly
      _ Several times in a month
      _ Monthly
      _ Less than once in a month

m. How well has the V2C actor been able to network it's customer companies with each other (rate with grading scale 4 – 10)
   _ 10
   _ 9
   _ 8
   _ 7
   _ 6
   _ 5
   _ 4

n. How could the V2C actor develop its operations?

____
____
____

4. Ownership

a. Does the company have V2C actors as owners?
   _ Yes
   _ No
   _ I can't say

b. Would you be willing to offer stock or options to bring outside committed partnership (businessman wisdom) i.e. buy knowledge with stock into the company?
   _ Yes
   _ No
   _ Maybe
   _ I can't say

c. Has this kind of a change been offered to you?
   _ Yes, by the current V2C actor
   _ Yes, by an outsider
   _ No
   _ I can't say

d. Would you welcome a significant increase in such a supply?
   _ Yes
   _ No
   _ Maybe
   _ I can't say

5. General satisfaction

(Answer according to plank 1.f)

a. Rate the V2C actor with grading scale 4 – 10
   _ 10
   _ 9
   _ 8
   _ 7
   _ 6
   _ 5
   _ 4

b. Rate the following matters with scale 1 – 5 (1 = Strongly disagree … 5 = Strongly agree)
   _ From the company's point of view, it has been a good choice to have a customership with the V2C actor
   _ The support, help, and involvement got from V2C actor has been in line with expectations

c. Would you recommend the V2C actor to other entrepreneurs?
   _ Yes
   _ No
   _ Maybe
   _ I can't say

6. Other wishes and comments to the researchers and V2C actors

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