

SSE Riga Bachelor Thesis



“SMART” vs “DUMB” MONEY:

Perceptions about Venture Capital of
Latvian Start-Ups and High-Growth Firms

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VENTURE CAPITAL

SMART MONEY: more important than how much money you get is who you get it from.

EXECUTIVE SUMMARY

- Struggling Latvian risk financing market and ecosystem
- Research focus: entrepreneurs' perceptions of VC value-added
- Market participant interviews & a company survey
- Approached **1202** high-tech / high growth firms
- **5.16%** complete response* rate (***62** complete responses)

Discovered MOTIVES in the VC financing decision:

AGAINST

- Local VCs lack tech skills & experience
- Individuals' reasons for starting the venture
- Past experience

FOR

- “Dumb money” (just money)
- Networking opportunities (especially abroad)

- AGENDA

- 1. WHAT WE DID:
Relevance & Knowledge Gap
- 2. HOW WE DID IT: Methodology
- 3. WHAT WE FOUND:
Results, Discussion & Conclusions



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INTRODUCTION

Relevance, Knowledge Gap & Study Focus

● VENTURE CAPITAL

- Capital for high-risk ventures which involve high costs of overcoming information asymmetry
- Usually **hi-tech** and/or **high growth**:

Life Sciences



ITC

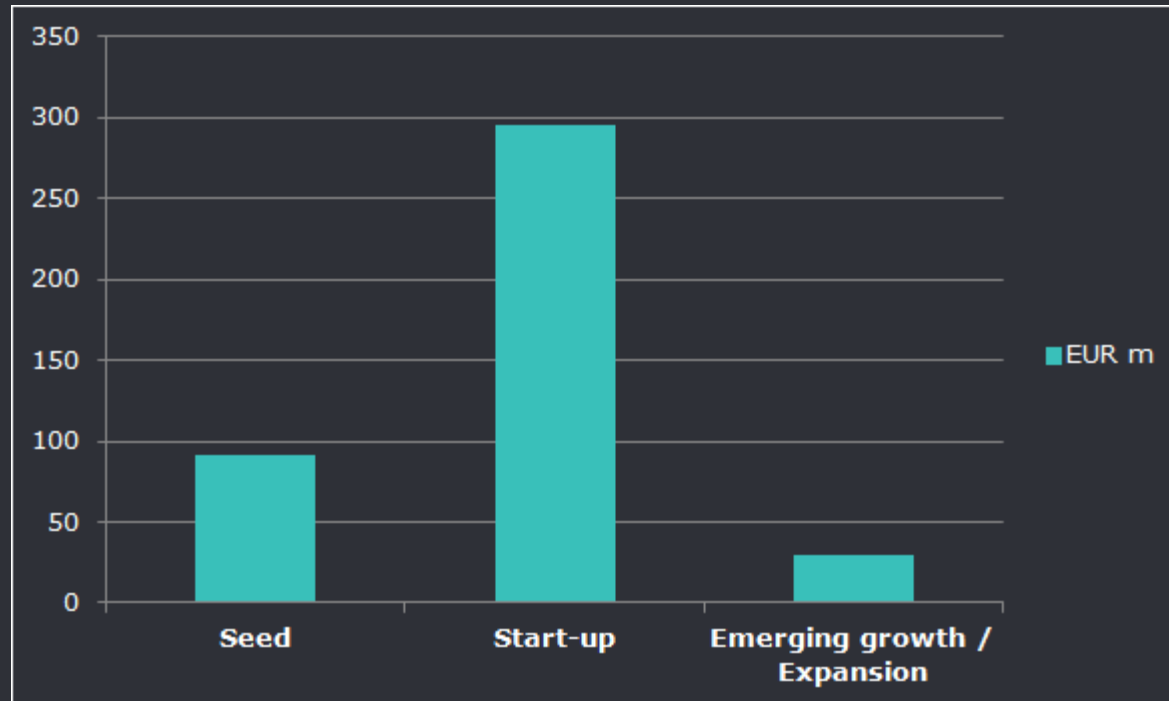


- RESEARCH & KNOWLEDGE GAP

- Value from this research added to:

- **Industry efficiency**: decrease asymmetries between supply & demand
- **Economic rationale**: the Latvian taxpayer
- **Academic community**: global lack of research on demand for VC

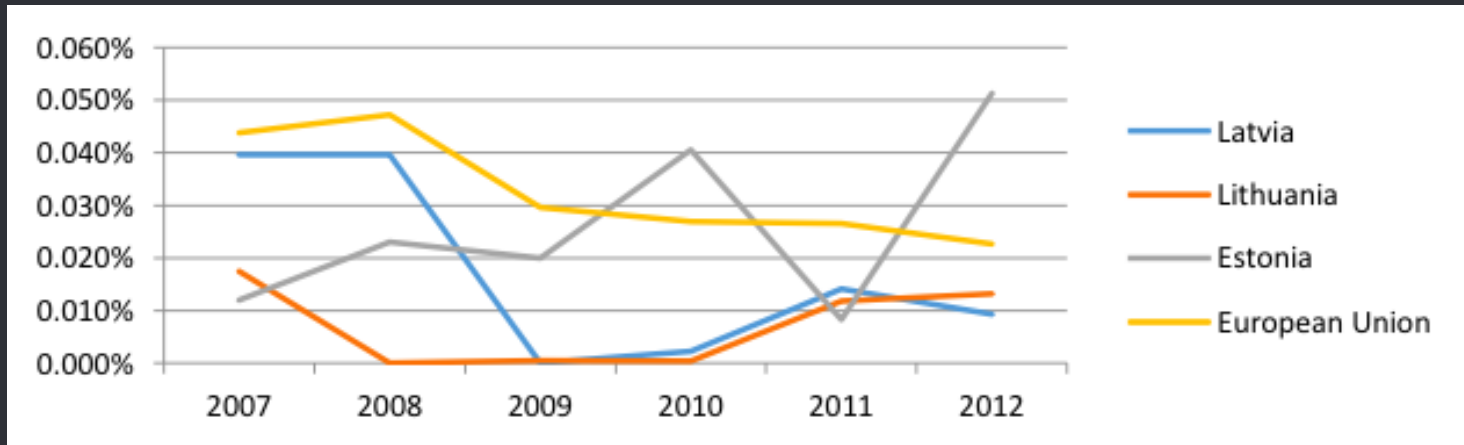
MARKET GAP IN LATVIA



Source: Ministry of Economics of the Republic of Latvia, 2014

VENTURE CAPITAL IN LATVIA

TOTAL VC INVESTMENT, % of GDP



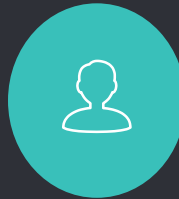
Source: Ministry of Economics of the Republic of Latvia, 2014

LITERATURE REVIEW

- “SMART vs DUMB MONEY” (Kaplan & Stromberg, 2001; Gompers & Lerner, 2001)



Technology



People



Financial

- SCREENING vs **MONITORING**

THEORETICAL FRAMEWORK

- COLLECTIVE **EFFORT** THEORY (Karau & Williams, 1993)

- **SELF** EFFICACY THEORY (Knockaert & Vanacker, 2013)

● RESEARCH QUESTIONS

1. What are the **reasons** for seeking risk financing among Latvian TBNVs* and high growth firms?
2. Do Latvian TBNVs and high-growth firms assume “**dumb money**” from VC funds?
3. Do Latvian TBNVs and high growth firms prefer **cross-border** VC financing to attract **technology investors**?
4. How does **aversion** to losing **control rights** and aversion to losing **cash flow rights** affect entrepreneurs' risk financing decisions?

* TBNV - Technology-Based New Venture



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METHODOLOGY

Interviews & Surveys

● PRIMARY DATA COLLECTION



INTERVIEWS

- 1 VC managers
- 2 LGA & LVCA
- 3 Semi-structured company interviews



SURVEY

- 1 Sample construction:
ITC, Life Sciences & high-growing ventures from Lursoft, AngelList: 1363 firms
- 2 Finding founders'/CEOs' e-mail addresses
- 3 Sent e-mails: 1308

INTERVIEWS

SUPPLY

Latvian VCs

- FlyCap
- Eko Investors
- Imprimatur Capital

LGA - public VC oversight body

LVCA

DEMAND

infogr.am

ask.fm

FROONT

MaxTraffic

tech hub

RESEARCH TIMELINE



INTERVIEW &
SURVEY
DESIGN

2014 Aug



INTERVIEWS
WITH SUPPLY
& DEMAND
AGENTS

Nov-Mar



FINALIZING
THE SURVEY

2015 Feb



SURVEY SENT
TO **1202**
ventures

2015 Mar

● METHODOLOGY: SURVEY LIMITATIONS

- Only Latvian ventures
- Classic VC demand \neq Past financed ventures in Latvia
- Database issues (Lursoft, Orbis): data lag, truncation
- Survivorship bias

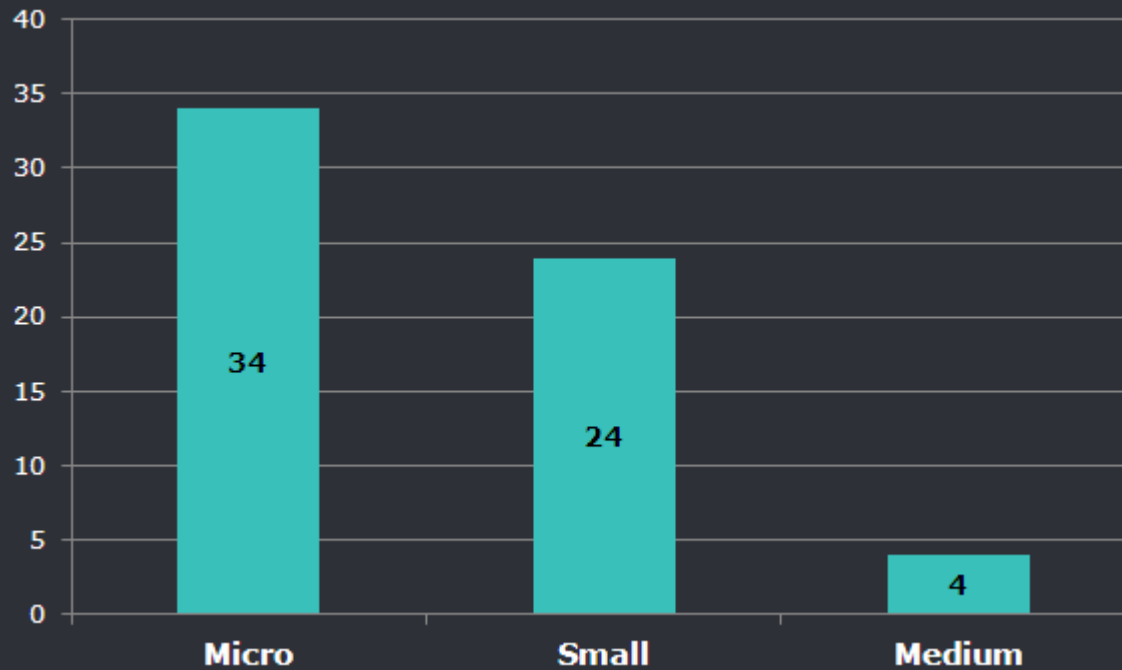


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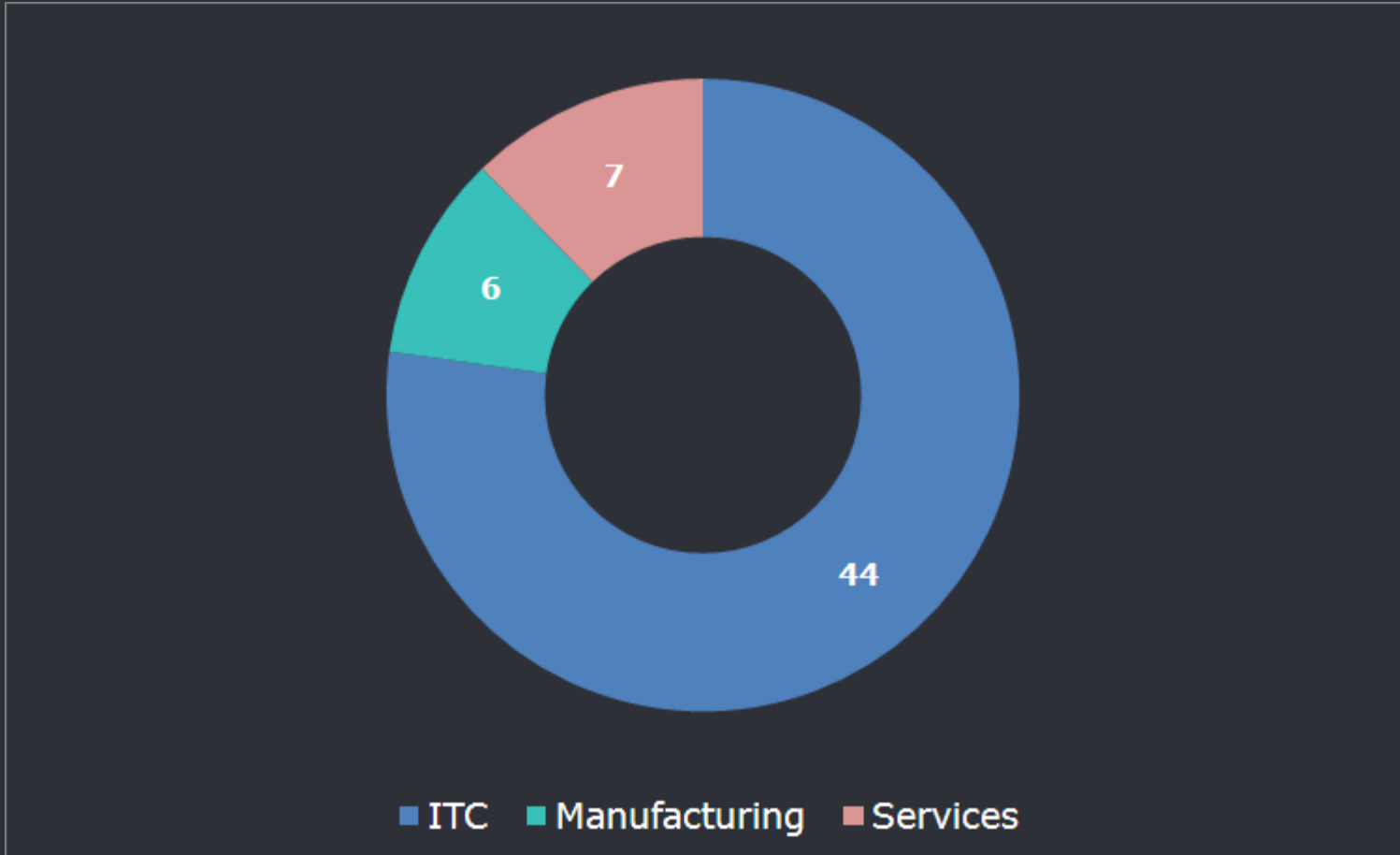
RESULTS

Expected & Unexpected Findings

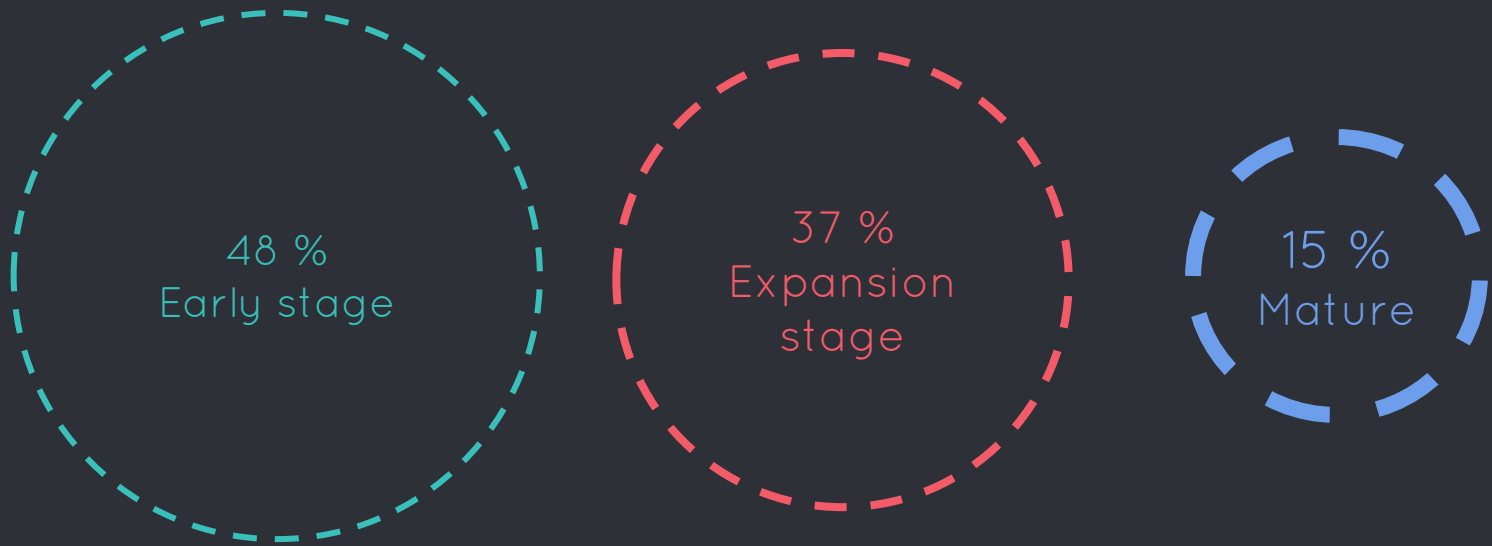
● SIZE OF SURVEYED VENTURES



● INDUSTRIES OF SURVEYED VENTURES



DEVELOPMENT STAGE OF SURVEYED VENTURES



● PERCEIVED ASYMMETRIES: COMPETENCES

PROVIDED

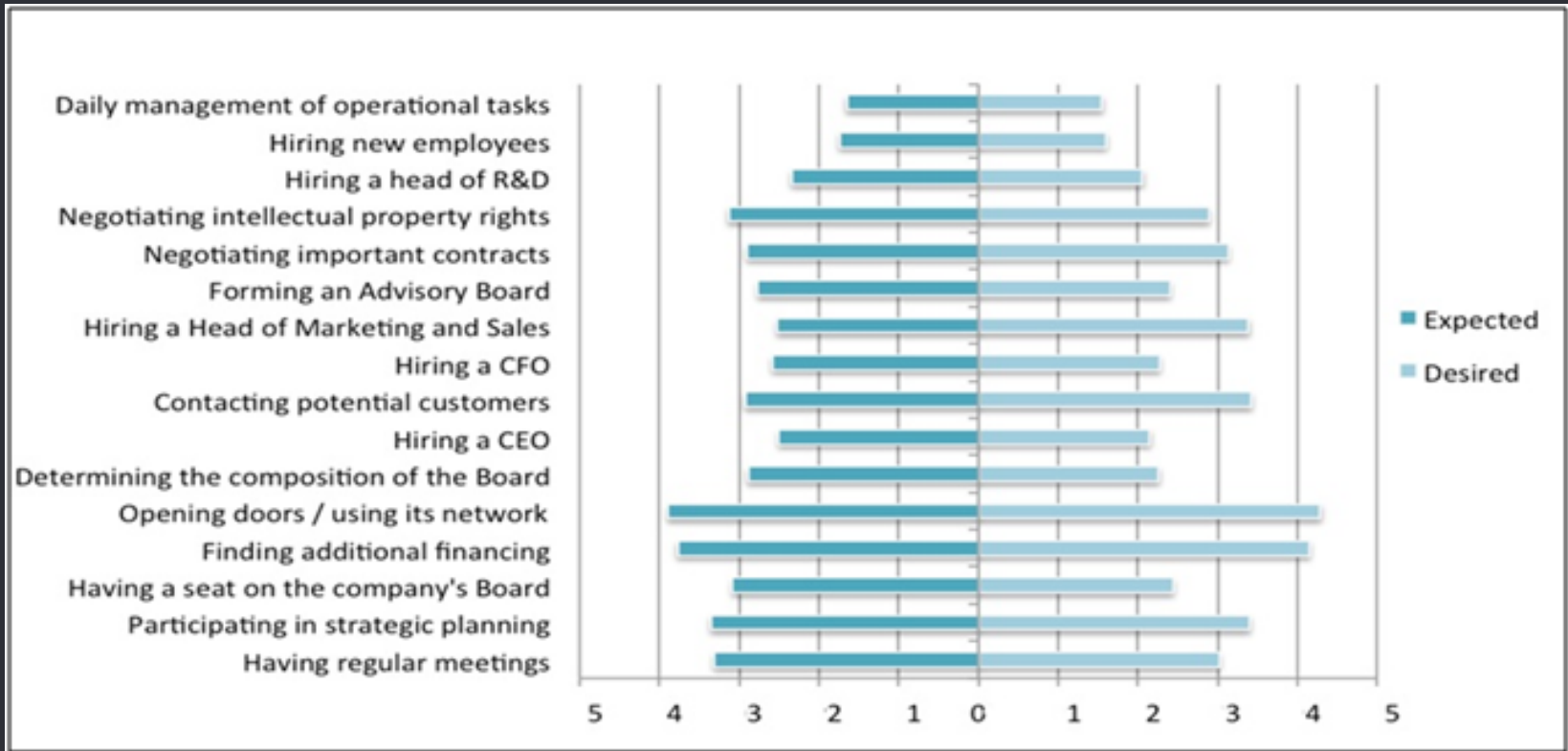
- Financial know-how
- General Management Experience
- Monitoring

IN DEMAND

- Business Networks
- Technology Know-How

PERCEIVED ASYMMETRIES: ACTIVITIES

RQ I: Reasons for seeking VC financing



Source: Authors' research

- RQ II: TBNVs' perceptions of Latvian VCs

- PORTFOLIOS OF LATVIAN VCS:
mature, low risk companies

- FUND MANAGEMENT TURNOVER RATE
“classic” venture capital skills
long term cooperation

- DECREASED POOL OF INVESTMENTS
supply side is seeking for companies
to invest in

RQ III: Reasons for seeking venture cross-border financing

Marginal differences in terms of smart money

Latvian TBNVs and startups comprise a small portion of foreign investors' portfolios

Encouragement to attract foreign venture capitalists

Strong in-house technology investor teams

Social loafing and collective effort theory

The less confident an investor feels about their capabilities to add value, the less likely they are to engage

RQ IV: Aversion to losing cash flow and control rights

REASONS FOR FOUNDING A COMPANY

Independence

Making money

Financial security

VENTURE FOUNDERS' MISTRUST OF VCS

Investment readiness

LACK OF TECHNOLOGY INVESTORS

Latvian VCs less likely to alter the founding team management

“

“Foreign investors have different valuation practices; the valuations we receive from local investors are considerably lower compared to those of foreign investors.”

--Founder of several startups

● CONCLUSIONS

To eliminate asymmetries

- **Latvian VCs** can add value by providing **networks** & attracting **additional financing**
- Obtaining tech skills - long & difficult process

To improve the ecosystem

- **Policy makers** can help spread the Latvian startup **success story**
- **Attracting cross-border VC** - more cost-efficient for small countries instead of developing locally?

To receive financing & value-added

- **Entrepreneurs** must increase **investment readiness**

Thank you!

QUESTIONS ARE WELCOME!