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ACCESSIBILITY AND PROCESSES IN PRIVATE EQUITY FUNDING

– Finnish Startups' perspectives



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ACCESSIBILITY AND PROCESSES IN PRIVATE EQUITY FUNDING - FINNISH STARTUPS' PERSPECTIVES

Funding innovative projects and companies is essential for a healthy economy. Lately, the discussion of ensuring a sustainable economy has been under a hot debate. Growth companies and startup companies have the need for equity for growing and internationalizing rapidly. At the stage of recession and with the EU tightening the bank sectors regulations, it has become more and more important to find ways to support new innovations and ideas. According to Ministry of Employment and the Economy Company Overview (2014), the government should offer more incentives for investors. How the entrepreneurs needs for equity has been met is a core of this thesis.

A company can get funding as own or foreign equity based, or as mezzanine funding which is a combination of the previous ones. The best and the most optimal equity structure cannot be defined, as it depends for example of the industry, country and taxation. The main focus in the thesis is in own equity based investments.

For matching the startup companies need for equity and investors interests to invest, a research was established for gathering information from the entrepreneurs about their attitudes towards the accessibility of private equity as well as their attitudes towards the investment processes. The research was carried through during spring 2015. Online survey was sent to 50 startup companies situated in the Southwest Finland. With 12 responds, the answer percentage was left to 24 %. The research revealed that there are room for improvements in the accessibility of investments. Also the processes were felt to be difficult in general.

KEYWORDS:

funding, economy, venture capital, equity, own equity, foreign equity, startup companies, private equity, investors, entrepreneurship, innovations

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PÄÄOMASIIJOITUSTEN SAAVUTETTAVUUS JA PROSESSIT – SUOMALAISTEN STARTUP-YRITYSTEN NÄKÖKULMIA

Innovatiivisten projektien ja yritysten rahoittaminen on elintärkeää terveelliselle kansantaloudelle ja viime aikoina kestävän kansantalouden takaaminen onkin ollut paljon pinnalla. Kasvuyritykset ja startup-yritykset tarvitsevat pääomaa jotta pystyisivät kasvamaan ja kansainvälistymään nopeasti. Taantumien sekä EU:n tiukemman pankkisääntelyn myötä on tullut entistä tärkeämmäksi löytää keinoja uusien innovaatioiden ja ideoiden tukemiseksi. Työ- ja elinkeinoministeriön yrityskatsauksen mukaan (2014) julkisen vallan olisi hyvä tarjota sijoittajille enemmän kannustimia jotta rahan liikkuvuus yrittäjille olisi todennäköisempää. Opinnäytetyön ydin on siinä, kuinka yrittäjien pääoman tarpeisiin vastataan.

Yritys voi saada rahoitusta joko omana tai vieraana pääomana tai välirahoituksen muodossa. Optimaalista pääomarakennetta ei voida tarkkaan määrittellä, koska se on riippuvainen myös monesta muustakin seikasta, kuten esimerkiksi toimialasta, verotuksesta ja maasta. Opinnäytetyö keskittyy oman pääoman ehtoiseen rahoitukseen.

Opinnäytetyön empiirisenä osuutena tehtiin kysely varsinaissuomalaisille startup-yrityksille. Tutkimuksen avulla saadaan tietoa startup-yrittäjiltä heidän asenteistaan pääomasijoitusten saatavuutta ja prosesseja kohtaan. Kysely lähetettiin keväällä 2015 yhteensä 50 varsinaissuomalaiselle startup-yritykselle. Vastaajien määrän ollessa 12, jäi vastausprosentti 24 prosenttiin. Tutkimus paljasti, että yrittäjät kokivat, että investointien saatavuudessa on parannettavaa. Myös prosessit koettiin yleisesti ottaen hankaliksi.

ASIASANAT:

rahoitus, talous, riskirahoitus, pääoma, oma pääoma, vieras pääoma, startup-yritykset, pääomasijoittajat, yrittäjyys, innovaatiot

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LIST OF ABBREVIATIONS

EVCA	European Private Equity and Venture Capital Association
FFF	Friends, family and fools
FiBAN	Finnish Business Angels Network
FVCA	Finnish Venture Capital Association
SME	Small and medium-sized enterprise
VC	Venture Capital; money provided by investors to startup companies or small firms
WACC	Weighted Average Cost of Capital

1 INTRODUCTION

In Finland, as well as in other western economies, the economy can succeed only if it can renew itself. For this renewal, funding innovative startup companies is essential. (Lainema 2011, 11) At the stage of recession and with the EU tightening the bank sectors regulation, the debate is how to ensure sustainable growth for the economy. Ensuring funding for long term investments, startup companies and small- and medium sized companies is the right direction for a healthier economy. For doing this, the government has added more possibilities for public funding and also given the investors some tax incentives. More initiative should be taken for ensuring more funding. According to Ministry of Employment and the Economy Company Overview 2014 (35), tax incentives are a key for gaining more funding both from Finland and from abroad.

Finland currently undergoes a structural change in the society. The share of industry from the GDP has decreased in all of the European Union countries, but the most in Finland. The significance in the service field has on the other hand increased. This renewal refers to a business activity and growth as a part of a so called "creative destruction". This destruction means that companies which do not have the keys for success disappear from the markets as the companies which do not disappear, keep on growing. (Ministry of Employment and the Economy, 2014, 6, 9, 25) Funding possibilities would offer more companies better changes to survive.

The relationship between own and foreign equity defines the equity structure the company has. Even though high solvency would be good thing from a risk analysis point of view, it is quite rare to meet a company without foreign equity. The optimal equity structure would minimize weighted average cost of capital, WACC. The best and the most optimal equity structure cannot be defined, as it depends of the industry, country, taxation and other influencing factors. (Ikäheimo et al., 2011, 157) Mezzanine funding is a combination of both, own

and foreign equity, and it can be classified as one form of funding. The main focus of the research is in own equity term based private equity investments.

1.1 The goals and meaning of the research

The purpose for the research is to study startup companies' opinions and experiences of financing their company with private equity coming from Finland and abroad and to find out whether the entrepreneurs feel that the private equity financing processes are difficult and especially from which parts. Funding a startup company can be very risky for an investor and a startup company might experience difficulties finding a suitable private equity investor from Finland. On the other hand, finding an investor from abroad might include difficult processes and challenges in finding one.

The research questions in the thesis are:

“How do startup companies in Southwest Finland experience the accessibility of private equity as a funding source from Finland and from abroad?”

“What kinds of processes are connected in finding and receiving private equity and how do entrepreneurs experience them?”

With these questions, the current situation of the accessibility and processes of private equity funding can be understood more as a whole. The reason for focusing more to entrepreneurs' perspective is the fact that a lot of guides and books for private equity investors are available, but up to date information from the entrepreneurs' themselves is missing.

1.2 Research background and motivation

The inspiration for writing this thesis was born from my own interest towards the subject as I have always found company finance interesting and important. When struggling to find a suitable topic from the field of finance, a friend of mine, working as a senior expert in a growing SME, was meanwhile struggling

with some of the processes connected to private equity funding. From this, the original idea for the thesis was created. I felt motivated to write about the topic as I found the subject challenging and interesting. I hope the thesis would offer its readers an interesting insight of the perspectives of startup entrepreneurs towards own equity term based funding.

2 STARTUP ENTREPRENEURSHIP IN SOUTHWEST FINLAND

A startup company and a growth company are sometimes used as partly synonyms for each other. This although does not represent them correctly. A startup company is usually a growth company, but a growth company is not necessarily a startup company. (Kielikello, 2013)

It is difficult to define the specific amount of startup companies, as it varies yearly. The evaluated amount also varies. In 2014, the number of startup companies started to grow. The strongest industries in Southwest Finland in 2014 were biotechnology, diagnostics and sea industry. (Varsinais - Suomen Yrittäjälehti, 2014)

Based on Startup 100's research, there are approximately 850 startup companies in Finland nowadays, with only 36 of them located in Southwest Finland. Different sources evaluate the amount of startup companies based on the funding applications: FiBAN states that 400 startups have sent their application in 2014 and The Finnish Funding Agency for Innovation (TEKES) claims that they have funded 660 startup companies in 2014. One reason why the numbers vary so much could be that the funding parties such as Tekes and FiBAN rely on the information the startup companies representatives give them and Startup 100 gathers the information directly. (Geektime, 2015)

1.3 A startup company defined

According to Kauppalehti (2014), there is no specific definition for a startup-company. Different sources define a startup company in different ways:

“A Startup is often meant an ambitious technology company, which aims to a fast international growth” (Kauppalehti, 2014).

“A startup entrepreneurship refers to a business, which aims to grow and create prosperity for itself. It can also be referred as a general term.” (Laukkanen, 2007, 17)

“It is the growth which differentiates startups from small companies. What it comes to company age, a five years old company can still be a startup, but companies close to 10 years old generally start ceasing to be a startup.” (Forbes, 2013)

“A startup can also be born in an already existing company, as new product or company ideas are born inside the company.” (Turku Science Park , 2015)

Referring to the last definition of a startup company by Turku Science Park, the company age can very well be older than 10 years old in this sense. It seems that there are many different definitions of a startup company but all agree that the key element in a startup company is its ability to grow. Startups are also generally speaking innovative. Nowadays startup entrepreneurship has been heavily marketed and it has been the core of many events, such as Slush. (Ministry of Employment and the Economy’s Company Overview, 2014, 44)

3 PRIVATE EQUITY AS A FINANCING SOURCE

Private equity can be considered as the umbrella term including venture capital, for instance in the United States. Nevertheless, the distinction between these terms is not made in Finland nor in Europe. In Finland, private equity investments are made by private equity investment companies and business angels. (PriceWaterHouseCoopers, 2006, 6)

Private equity investors usually invest in companies which are not yet quoted in the stock market and which have good views for the future. An investor typically brings also other added value increasing the value of the company. (Ikäheimo et al., 2011, 141-142) This added value could be for instance creating strategies, funding arrangements as a whole, working alongside with the company's board of directors, budgeting, marketing, management development or expertise and knowledge about the markets. Having a private equity investor increases the reliability of the company. It also improves the chances for getting more funding from a different source. (FVCA, 2015)

The aim of the investor is to detach from the company after a specific time period. The goal for the investment is to grow and develop the company in such ways that the company could be sold to some other company or be quoted in the stock markets. (Ikäheimo et al., 2011, 141-142) An investor also naturally wants sufficient profits for the funds it has provided. The profit the investor expects depends of the risk it has taken. (Profita Group, 2014)

Private equity investments are usually made as own equity term based investments or as mezzanine investments. Funding instruments can vary, the most typical being investments made to company's shares and convertible bonds. (FVCA, 2015)

3.1 Financing a startup company with private equity

Startup companies require more funding than normal ones for growing and internationalizing rapidly. In 2009, according to Department of the Treasury (2009), new and grow stage companies encountered difficulties in finding private equity investors or even getting a bank loan. Recent study by Ministry of Employment and the Economy of Finland proves that nowadays startups have been receiving funding and investors from abroad with good results, so the situation has improved. This is although conflicted with the weak current economic situation in Finland. (Ministry of Employment and the Economy's Company Overview, 2014, 42)

A company develops in four different stages. These stages are seed stage, startup stage, early stage and later stage. (Van Osnabrugge and Robinson, 2000, 19) According to FiBAN (2015), the investment type varies depending on the stage the company is going through. From figure 1, "Company stages and investments" the matching investors and stages can be analysed further. From the FiBAN definitions, the startup stage has not been introduced.

According to FiBAN, the investors in the seed stage are business angels and FFF. Later on the investors are more likely to change into venture capital investors. Foreign equity can also come in forms of acquisitions and strategic alliances. Funding in the seed stage is crucial, as the company goes through the "valley of death". In this stage, many startup companies are forced to give up if they don't receive enough funds and support for their business. (FiBAN, 2015)

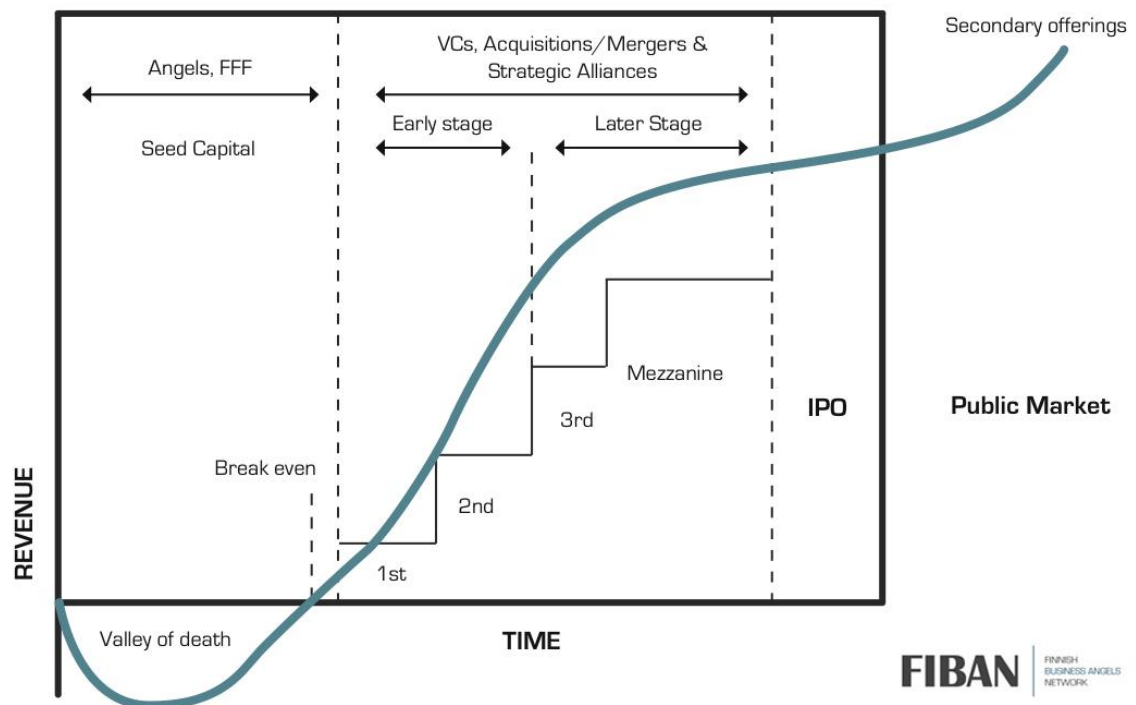


Figure 1: Company stages and investments (FiBAN, 2015)

3.1.1. Friends and family

Friends and family are the first ones to invest into a startup company, alongside with the business angels. They can provide the seed capital the startup company needs. There can although be risks of losing or breaking relationships, if the investment won't go as planned. Having investments made by your family or friends is although very good to have, as for instance some business angels won't even think of investing if they are not involved with any investments. (Business Angel Institute, 2013)

3.1.2. Business Angels

Business Angel is referred to a private person, who invests in a non listed, potential startup company. Especially the investors' own know how and networks are emphasized besides the funds it offers. According to research, the

possibilities for a startup company to succeed is more likely if it have had a business angel investing to it. (FiBAN, 2015)

When applying for a business angel investment, one must know that the investments the angels usually make, are smaller than investments from venture capitalists. Business angels commonly invest in startups or early stage companies, when institutionalized investors might consider those ventures too risky. Business angel investments tend to be flexible, including so called “patient money” and shorter investment processes. Most business angels can also add value to the company. Business angel investments can also although include a few disadvantages. They rarely do follow-on investments to the same company and the investors preferring to have a decision making role are examples of the disadvantages the investment might give to the entrepreneur. (Van Osnabrugge and Robinson, 2000, 63 – 67)

For the startup companies possibilities for gaining more funding from business angels, the government has created a tax incentive for the investors from 2013 until 2015. The tax incentive is meant for a business angel investing on a small, less than 6 years old company. The investor can reduce 50 percent from its equity income the year of the investment. This incentive is although only a transfer of taxation as the income previously reduced is added to the investor’s equity income when giving up the shares of the company invested. (Ministry of Employment and the Economy Company Overview 2014, 42)

3.1.3. Corporate venturing

Corporate venturing can mean either indirect or direct corporate venturing. Direct means a company investing directly to the company in question, indirect on the other hand means a company investing on a private equity fund controlled by an independent private equity investor. (PriceWaterHouseCoopers, 2006, 7) The indirect corporate venturing has been

opened a little bit further in the next chapter. In Finland, the Finnish Venture Capital Association helps to forward the prerequisites for operations and promotes the investors' interests. (Suomen Yrittäjät, 2014, 7)

3.1.3.1. Indirect corporate venturing

Venture capital companies control trusts, which further invest into prospective companies. These trusts are generally limited partnership companies. The following figure will demonstrate more specifically the private equity investment process made by venture capital companies:

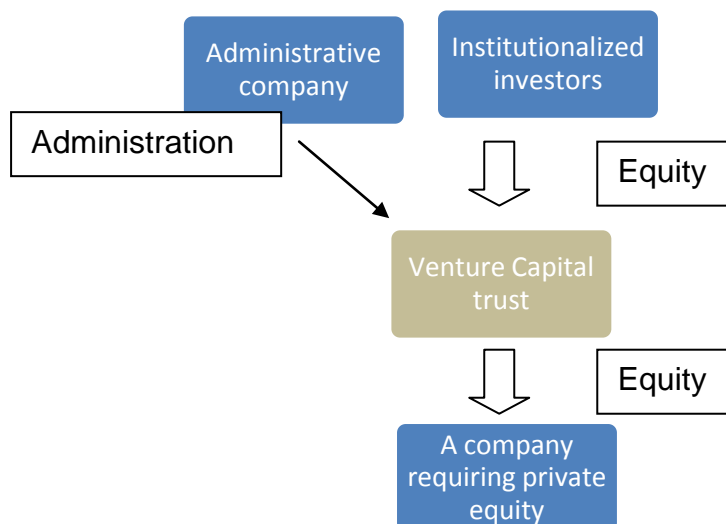


Figure 2: Cashflow in indirect corporate venturing

The equity usually comes from institutionalized investors such as retirement funds, funds for different kinds of trusts, life insurance funds, foundations and other institutions. These institutionalized investors give private equity for a trust, which is established by an administrative company just for funding purpose. This limited liability company, further on, funds suitable companies. Private

equity is requested from the institutionalized investors when its needed and returned when exiting the company. The administrative company gives the venture capital company advises and suggestions concerning investments and exits. It also searches for potential companies requiring funding. Strong networks are essential for administrative company for making a successful investment. (CapMan, 2013)

The most significant sources for private equity funds in Finland has been retirement and insurance companies. The private equity funds devide further on into buyout funds, closed - end funds, evergreen funds, feeder funds, funds of funds, mezzanine funds, secondary funds, venture capital funds, white label funds, funds by agreement, turnaround funds, collaretal debt obligation funds and different hedge funds. Most funds are closed - end funds. Venture capital funds invest on early stage companies. (Hidén and Tähtinen, 2005, 19-26)

Most mentionable venture capital offerors for startups in the Southwest Finland area are Aboa Venture and Aura capital. Aboa Venture offers own equity based financing and ownership solutions for companies in different industries. The main invest area is Western Finland. (Aboa Venture, 2014) Aura Capital invests mainly startups and early stage companies and gives to invested companies operative and strategic assistance and financial expertise (Aura Capital, 2013).

3.1.4. Public funding

There are many sources for public funding. The most important ones connected to venture capital are presented further. These funders are Tekes, Sitra, ELY Centre and Finnvera.

The Finnish government has set procedures for improving the operations within the financial markets. One step is to focus the private equity funding for seed stage companies in Tekes. As a conclusion for this change, Tekes will be

focusing more to young startup companies. Also long term funding will be supported with two funding programmes. (Ministry of Employment and the Economy's Company Overview 2014, 10)

Tekes offers a combination of both, loan and grants for young innovative companies. The company should be less than 5 years old and the amount of employees under 50. The company can get funding maximum 500 000 euros as grants and 750 000 euros as a loan. Previously the funding from Tekes has been only grants, but the funding model has changed in the beginning of the year 2015. (Tekes, 2014)

Sitra is a public fund which reports directly to the Finnish government. Sitra offers fund investments, corporate investments and project funding. Nowadays, Sitra is emphasizing on fund investments and direct corporate investments are made only after careful consideration. Sitra does not grant any free support or scholars to companies. (Sitra, 2015) Previously Sitra had a co-operation model, which aimed to connect interesting growing companies, knowledge investors and venture capital investors. The success of a growing company requires simultaneous control of many different factors and the model was helping to achieve these factors. This model was although ended as it was removed to Finnvera. (Lainema, 2011, 70)

Centre for Economic Development, Transport and the Environment (ELY Centre) offers development grants for companies which are internationalizing or developing and renewing their business. The main focus the ELY Centre has is in internationalization. The development grant can be admitted to SME companies which have preconditions for profitable business and enough resources for development actions which would ensure better competitiveness. (ELY Centre, 2013)

Finnvera makes public private equity investments directly to early stage companies. Finnvera is functioning as the official Export Credit Agency of

Finland. Finnvera offers wide range of financing solutions, one being venture capital investments. These investments are made as funds of funds principle. Finnvera's subsidiary, Veraventure, is a fund for direct investments to potential companies. The investments are made to early stage technology companies and technology intensive or innovative service companies, which have potential to develop also internationally. (Finnvera, 2015)

3.1.5. Other sources for private equity

Other possible sources for receiving private equity are bank loans and financing companies (leasing and factoring funding). These private equity financing forms although differ from previous ones as they are foreign equity based funding sources. If the company would not be able to do any down payments anymore, the most extreme situation the investor could get the company into bankruptcy. (PriceWaterHouseCoopers, 2006 9-10) A significant difference between own and foreign equity is that the cost of own equity is dependent of the market's required rate of return (Ikäheimo et al. 2011, 144).

One form for getting private equity is also equity based crowd funding. Crowd funding is an open and passive way of funding. Crowd funding basically means a large group of people offering funding for a company with relatively small stakes. For a startup company, this is a good way of raising equity with little risk. Crowd funding offers a way of applying funding globally. It can also give a boost for the company's internationalization. The markets for crowd funding has been estimated to be billions of euros, but no specific numbers can be presented. Even though the Finnish crowd funding industry has been growing, the industry is still in early stage and it takes time before it can become a permanent option besides the traditional funding possibilities. (Ministry of Employment and the Economy, 2014, 11, 54)

The most benefits private equity investments give to companies which are too small to be quoted in the stock, have not existed for a long time and which are not reliable for getting a bank loan or similar because of the nature of their business. (Yritys - Suomi, 2009)

3.2. Private equity investors from abroad

A startup company can also try to get funding from abroad. In the early stage this might although be difficult if the company does not have any specific relationship with the funding party or strong bond to other markets (Malila, R. 2015). Foreign equity is necessary besides the Finnish one. Foreign investors can invest more money to single companies and they are also able to give the international know how. For a startup company willing to go international, a foreign investor can give more benefits than a Finnish one. (Pörssisäätiö, 2009, 30) A foreign investor can have a place of business in Finland, from where he/she coordinates the investments. Part of the foreign investors work from abroad and they can for instance do joint ventures with a local investor. (FVCA, 2015)

The private equity industry is more advanced in many other countries compared to Finland. If the industry in which the company works is new or small, it would be beneficial to seek an investor from abroad. To have an international investor on board might as well help to get other investments. (Hyvinvointiklusteri, 2013) Typically a private equity investor gets a decision making role in the company in exchange of funds it has provided. (Yritys – Suomi, 2009) This can be seen as a benefit, but also as a threat. Also the company should take caution when applying for private equity.

4 PROCESSES

Usually the investment process lasts 6 months, sometimes even more. So, for quick money, private equity is not the right road. For the entrepreneur willing to have a private equity investor involved in the company at some point, he or she should try to have unofficial conversations with potential investors. This way, the entrepreneur could for instance receive feedback and identify the investors with whom the investment process could be carried further. (Länsipuro, 2011, 6) The entrepreneur can get disappointments if the investor estimates the company value lower than the entrepreneur. Processes can vary depending on the investor. (Van Osnabrugge and Robinson, 2000, 115-212)

4.1. Finding a suitable private equity investor

It would be beneficial to fund a company as far as it can be funded with the assistance of friends and family. Funding from other sources should be sought only after it comes compulsory. (Lainema, 2011, 111) Networking is one of the ways for finding a suitable investor, especially if the entrepreneur wishes to find a business angel. Friends, family, former colleagues and work connections might help in making the venture a success. The entrepreneur should take the most of his or her's personal and professional networks and connections. When getting one investor on board, helps in later stage ventures. (Van Osnabrugge and Robinson, 2000, 78) In Finland there are also networks and associations that help to find investors. FiBAN is a Finnish Business Angel Network and it matches companies for free with the potential investors (FiBAN, 2015). FVCA, Finnish Venture Capital Association, on the other hand, is a network for finding a suitable venture capital investor (FVCA, 2015). The entrepreneur could also try to get an equity investment from a public source.

The investment plan should also be characterized at this point. The pros and cons for having an investment should be evaluated. The entrepreneur should

also think about the amount of desired investment and which share of ownership would be given for gaining it. Studying about potential financing sources and ideal investor characteristics should be emphasized. (Lainema, 2011, 111).

4.2. Business plan

A good business plan helps to find investors for the company, but the business plan is not actually always primary. How the entrepreneur presents the business plan reflects how well different sectors in the business plan are considered. For the investor the characteristics the entrepreneur possesses are important in making the investment decision. Nowadays, the investors might not have a lot of time to go through business plans.

Building the relationship with the investor starts from the first time you approach him or her. It is important to give a honestworthy and reliable picture as the investor will hopefully accompany for a long time. The business plan should be presented detailed and you should know it by heart. (European Private Equity and Venture Capital Association, 2007, 24)

4.3. Negotiations

The negotiations between the investor and the entrepreneur hold many stages. When the discussions have been started with the potential investor, the entrepreneur should start evaluating the investor more closely. For instance, a simplified presentation of their portfolio as well as the results of their investments could be asked to be seen. The price of the equity is a crucial point in negotiations. The entrepreneur typically evaluates the company higher than the investor, so good negotiation skills are in hand when finding a common solution. According to the European Private Equity and Venture Capital Association's Guide on Private Equity and Venture Capital for Entrepreneurs

(2007, 26), an entrepreneur should accept the price if it comes close to his own evaluations as provision of equity is more important than winning the negotiations in the long term.

4.4. Due diligence

Due Diligence is usually made before the private equity investment is made. The company is being carefully analysed by the investor who intends to invest the company. (Vaihekoski, 2005) In the due diligence process, different operational areas of the company are being monitored. Typically the process contains economic, legal, operational, environmental and tax related due diligence. The buyer due diligence is suppose to correspond the image the investor had received from the business plan. (PriceWaterHouseCoopers 2006, 29)

The entrepreneur should also prepare internal due diligence just for internal purpose. With this, the purpose is to investigate more closely the potential investors and their suitability for the company. The entrepreneur should not just jump on board with the first investor which shows a white flag. (Lainema, 2011, 112)

4.5. Term sheet

Term sheet means the preliminary conditions of the investment agreement. It shows the new equity structure and the main characteristics of the new agreement. Term sheet fastens the investment process. As a whole, term sheet is not juridically liable, so the entrepreneur and the investor can avoid commitment issues which might occur in a preagreement contract. If the entrepreneur agrees with the terms the term sheet states, a final documentation for the investment is made based on the term sheet.

It is usually the investor who makes the term sheet. The term sheet puts together the most important financial and juridical terms and puts the value of the investment into numeric form. The entrepreneur can approach potential and previously refused private equity investors and institutionalized investors with a signed term sheet. This is important for a company's later stage investments and bridge fundings. Even though the term sheet is not juridically liable, both sides reputation is on the line, so good commercial customs should be obeyed. (Lauriala, 2004, 53-55)

4.6. Monitoring

Many investors choose to monitor the investment made. Usually business angels are the ones, who prefer more close monitoring compared to the venture capitalists. Passive monitoring, which venture capitalists are more likely to do, include advising on business strategy, monitoring financial statements and involving to the board of directors. Business angels, on the other hand, are more likely to take an active, hands - on role in the company invested. (Von Osnabrugge and Robinson, 2000, 188-190, 197)

4.7. Detaching from the private equity investor

The exit usually happens 5 - 10 years from the investment. Venture capitalists emphasize much more on exit strategies than business angels prior the investment. Potential exit routes are for instance trade sale or acquisition, sale of shares to other shareholders, sale to third parties, going public or liquidation of assets. The most common one is going public. (Von Osnabrugge and Robinson, 2000, 201-202) The cost of own equity can be considered to be lower when the company is listed. It can also bring benefits connected to marketing and recruitment. (Ikäheimo et al., 2011, 143)

Detaching from the private equity investor might set a lot of pressure to the startup company. The investor of course would require a satisfactory end for its investment with return for its capital and this sets the pressure. (Von Osnabrugge and Robinson, 2000, 201 - 202) In the financing markets, the rule “profit and risk go hand in hand” apply. This basically means that no investor is willing to take a high risk without receiving high profits. (Ikäheimo et al., 2011, 143)

5 METHODOLOGY

According to an old saying, a good question is already a half of the answer (Hirsjärvi et al, 1997, 119). The research questions in the thesis focused on studying and learning the perspectives the startup companies in Southwest Finland have towards own equity based private equity funding. For this purpose, a survey was made and sent online to potential companies.

5.1. Research methods

The methodology used in the thesis has features of both, qualitative and quantitative methods. The research aims to be as objective as possible; as the survey was sent online the target group is never met personally. The interpretation of the results can although vary depending on the frame the researcher puts them to. This is why the objectivity is not necessarily as high as it could have been. (Salkind 2009, 105) The scale used in the survey was ordinal, including mainly closed questions, but also a few open ones.

5.1.1. Survey

The survey was online based and sent via email to the sample group. The survey is as an attachment 1. One of the rules for sending a survey is keeping the questions as simple as possible and the survey itself as short as possible. It is recommendable to use questions from previous researches for confirming the reliability and validity of the research. It is also important to pilot the survey to someone, friends or colleagues for example. (Dahlberg and McCaig, 2010, 180) A survey gathers information data at a specific point in time and it is one of the few techniques offering information on attitudes (Burns, R. 2000, 566-568).

5.1.2. Sampling

Besides a specific company type, startup entrepreneurs, the survey was directed according to geographic factors. So, the basic group includes two major factors: companies are startup companies and situated in Southwest Finland. The list of the companies including to the basic group was made before the random selection. Information loss in means of non answered questionnaire should be prepared when considering the sample group. Because of the small size of the basic group and impossibility to gather all of their contact information, a discretionary sample was created.

A list of startup companies was made before starting the research. Information for this listing was found from many startup company listings from Finland and abroad. The survey was also sent to some specific companies participating in science park startup activities. Only the really new startups seemed to be excluded from the basic group, due the lack of contact information. The sample group was studied carefully before sending the survey. Age of the company was specifically taken into account.

5.2 Reliability and validity

The research succeeded to be as objective as possible. Even though the survey was sent to a discretionary sample, it was considered to be pretty close to the basic group. The definition of a startup company was based on careful research and background checking. The basic group was small in the beginning, so the questionnaire could not be sent to a larger group without expanding the target criteria.

For revealing the attitudes better, more open end questions could have been added to the survey. The respondents although gave good statements which helped in the analysis of the survey. The results can only be considered to

cover the attitudes of the respondents and partly the attitudes of all the Southwestern startup companies in this specific point in time.

6 RESEARCH RESULTS

The survey was sent in total to 50 startup companies in the Southwest Finland area. The sample was close to the basic group, as the basic group for the research is small and specific. Sample was although discretionary as the companies chosen for the research were studied a little bit before the selection. A company list was made and the companies chosen for this were selected from multiple sources and listings, such as Startup 100, Arcic Startup, Turku Science Park, Kauppalehti and Geektime. It was discovered, that it was difficult to discover and find especially young startup companies from these listings. Typically they were closing mature age already, even though they were in recent startup listings. It also seemed, based on these listings, that there were not so many startup companies in Southwest Finland, when you compare to Finland as a whole. The most startups were situated in Helsinki - Uusimaa region and in Northern Ostrobothnia.

The research was not easily executed, as the companies were not so easily found. A lot of preliminary study about the companies was made before sending the survey forward. The respond percentage was 24 %, as 12 companies answered to the survey. The survey was made and sent in Finnish, but translated into English for the thesis research results. The survey, covering letter, reminder note and thank you letter are as attachments.

For opening up more the research results, the whole questionnaire is opened furthermore in order of the questions. In the beginning, some general data was required, such as company industry and size.

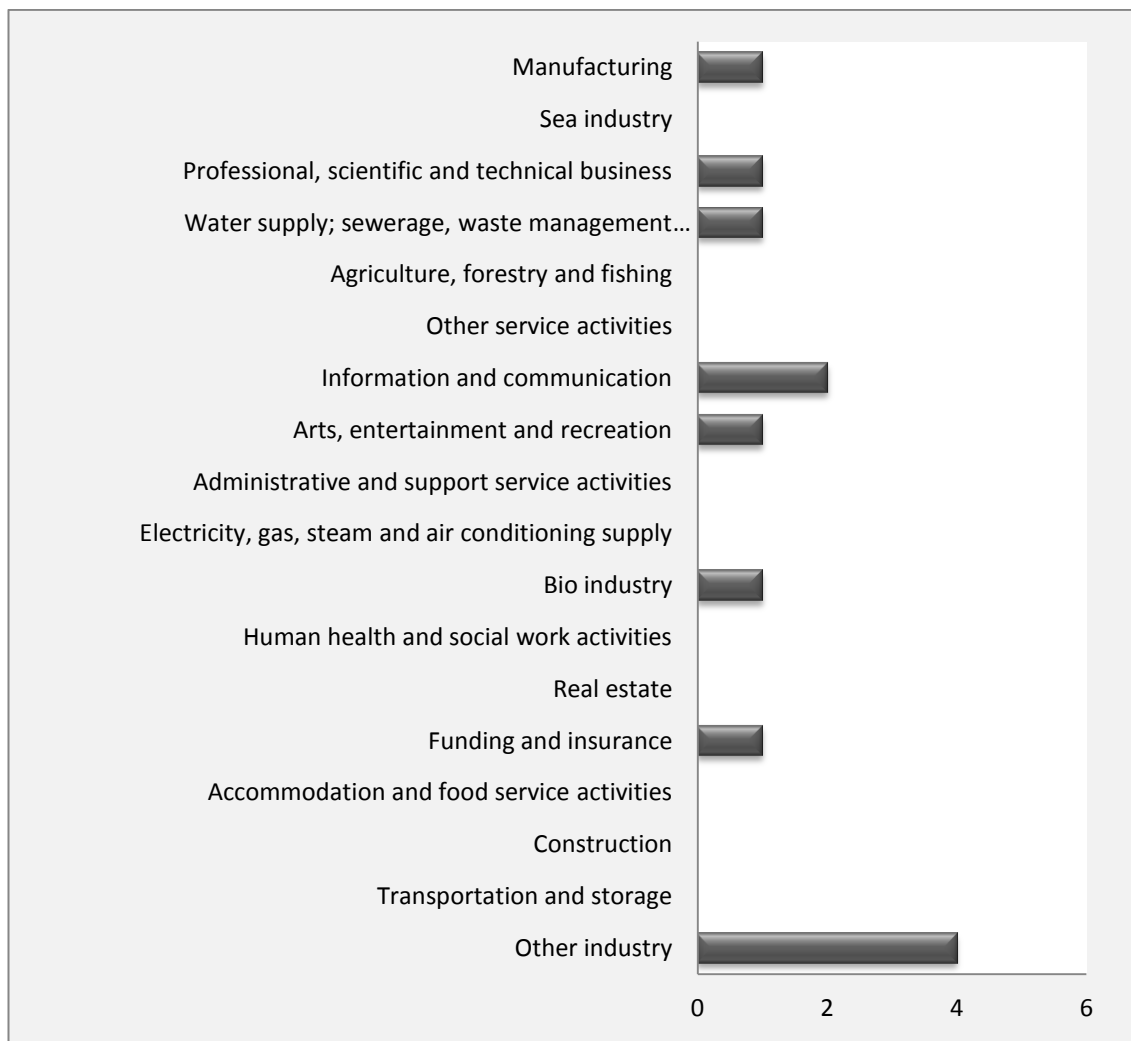


Figure 3: Company industry

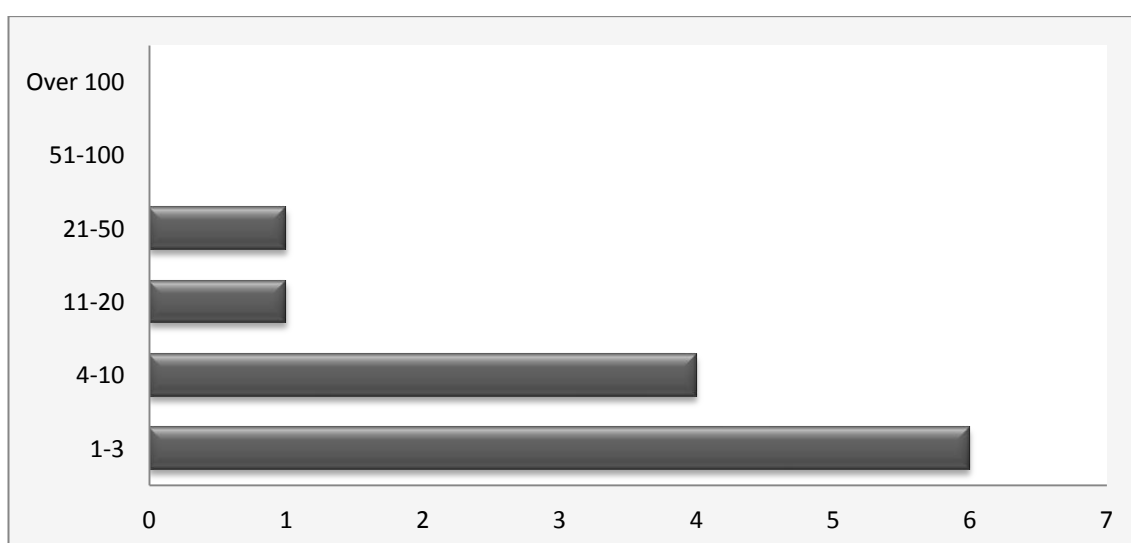


Figure 4: Company size

The industry options for the first question were collected from Statistics Finland's definitions. Five of the respondents gave the answer: "other industry", which refers that either the industry list was defective or the company is working within not so traditional industry. The second largest industry was information. Most of the companies were small, as expected, but among the respondents were also two bigger companies, which probably were already in a more mature stage than the ones with small personnel numbers.

Usually some forms of external funding is used in a company, whether it comes from family or friends or as a form of a bank loan and as seen from figure 4, most of the respondents had used external funding in their company. There were although three companies, who had managed to stay without external financing sources.

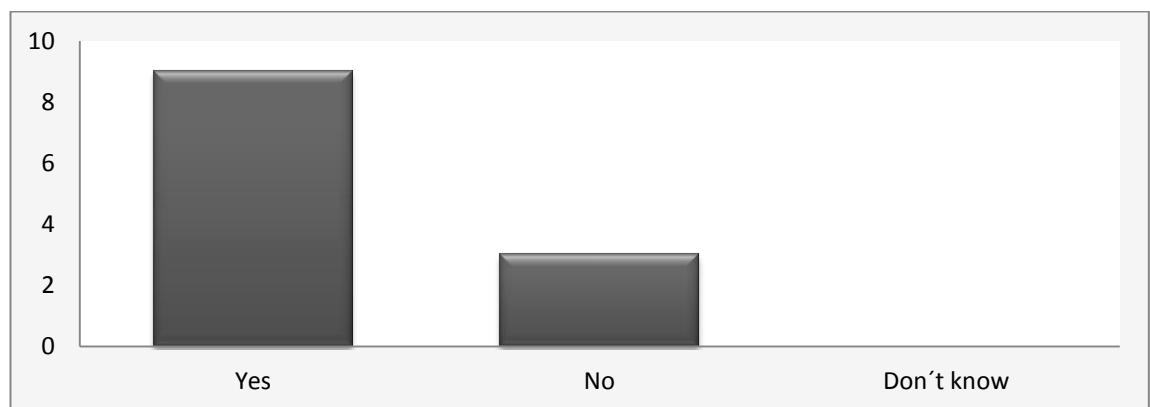


Figure 5: Usage of external funding

The knowledge base of the entrepreneurs was wished to be understood better. Most of the respondents stated that they have a good knowledge of own equity based funding. Only two of the respondents replied they have a poor or satisfactory knowledge. The question was an open one, and it received comments such as:

“ Pretty good, I am an entrepreneur who had done an exit previously and had an private equity investor on board in my last company. On top of that, we are currently seeking for an investment”.

“ Very good”

” Minor experience”

” Years of follow up and proactive touch”

According to most of the respondents, the knowledge base was quite good.

Question four concerned receiving own equity term based funding from a business angel or from a venture capital investor.

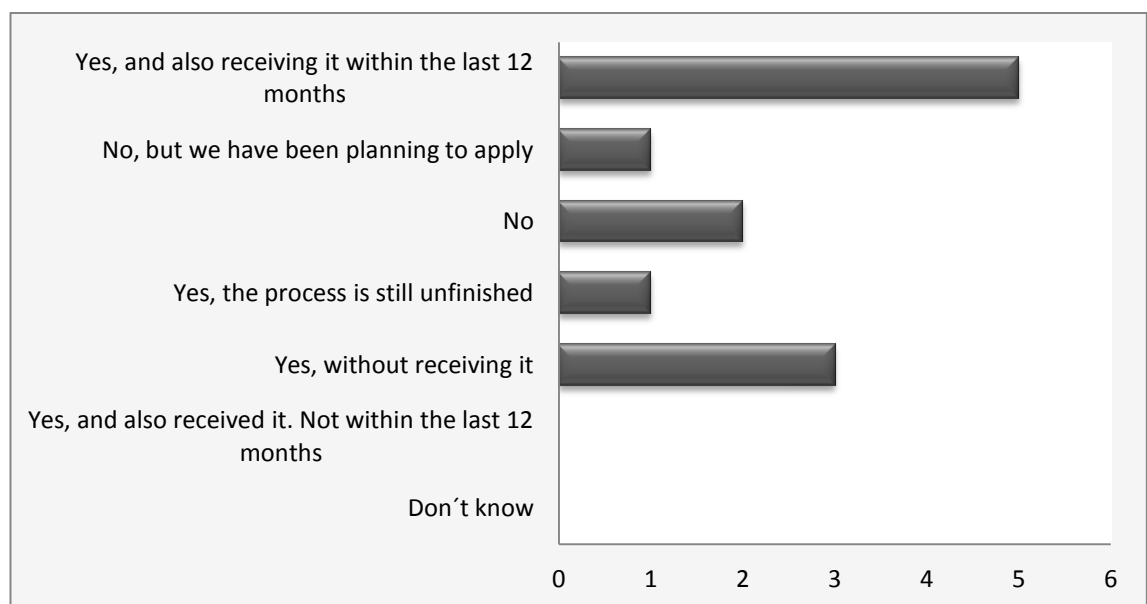


Figure 6: Receiving own equity term based funding from a business angel or from a venture capital investor

Five companies had received funding from a business angel or venture capital investor within the last 12 months. Three has been left without. Most of the entrepreneurs had applied funding from a venture capital investor or a business angel. Receiving funding from a public investor was also asked for comparison to the previous question. In the survey, public funding was meant only scholars and private equity investments, excluding company loans.

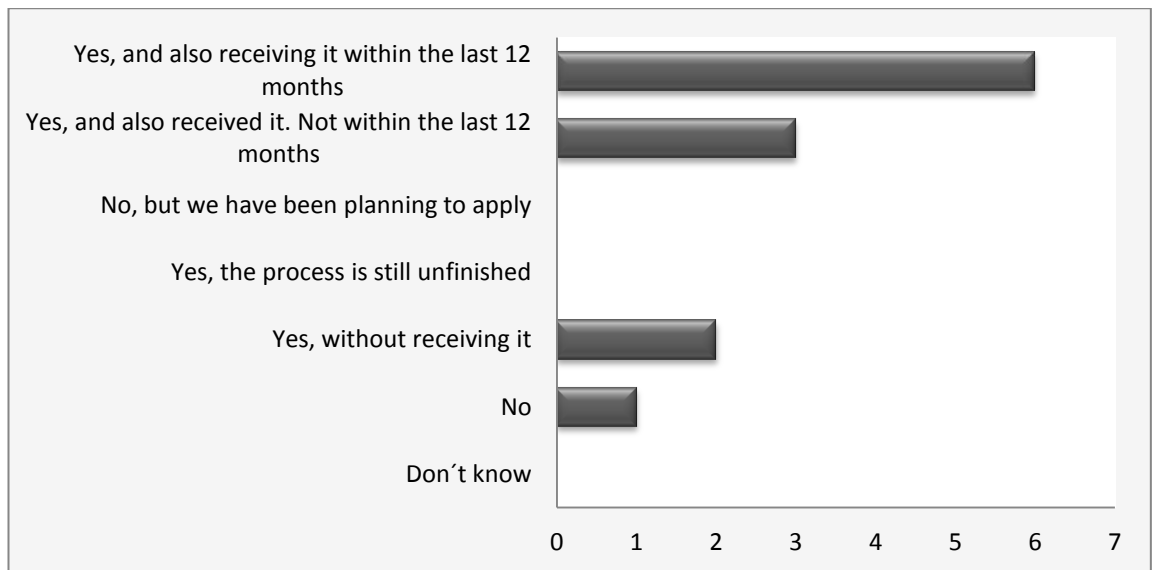


Figure 7: Receiving public funding

Most of the companies had applied and received public financing (75 %), which of half within the recent 12 months. Only two companies have been left without receiving funding. From these results, it seems that public financing as a source of private equity is considered to be more approachable for applying for it, also receiving it is more likely than private equity from a business angel or venture capital investor.

It was important to get a vision of the companies' perspectives on receiving private equity from Finland and from abroad, so the following question focused on the accessibility of equity.

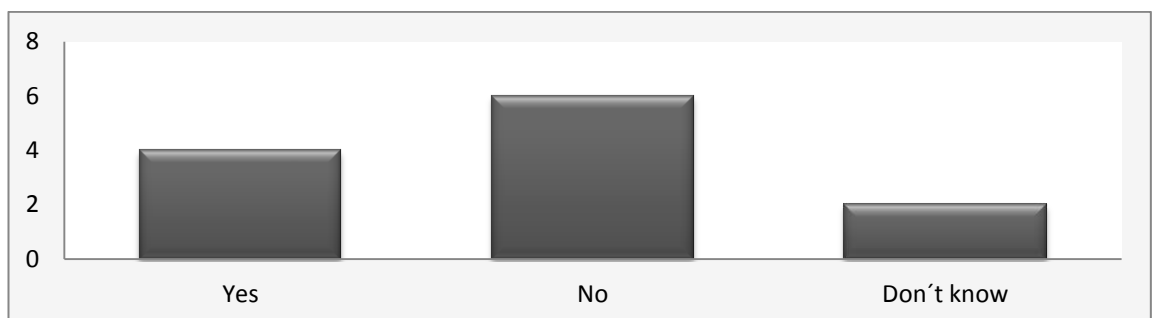


Figure 8: Receiving private equity in Finland

Half of the respondents considered, that private equity was not easily available in Finland. 33,3 % considered that it was easily accessible and 16,7 % could not answer the question. Most of the respondents who stated that private equity was not easily available in Finland had previously applied for funding and left without receiving it. These respondents also state that their knowledge of private is good.

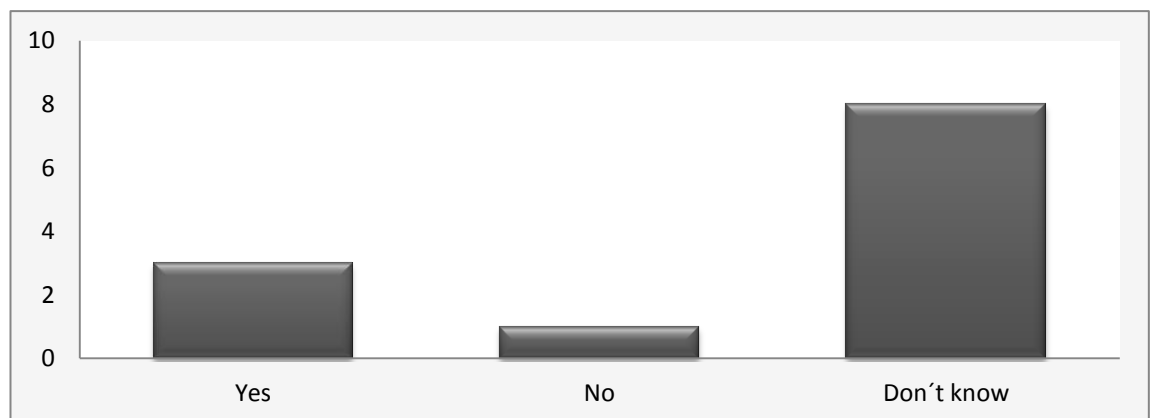


Figure 9: Private equity from abroad

66,7 % of the respondents could not answer the question concerning accessibility of private equity from abroad. This could be due to lack of knowledge. It is likely, that is it not because of there would be a lot of private equity funding possibilities in Finland, as question 7 reveals that half of the respondents did not consider it was easily accessible. 25 % did think it was easy to access private equity from abroad, leaving only 8,3 % considering that it was not easily accessible.

There are many different ways of receiving private equity and the most likely sources of private equity wanted to be explored.

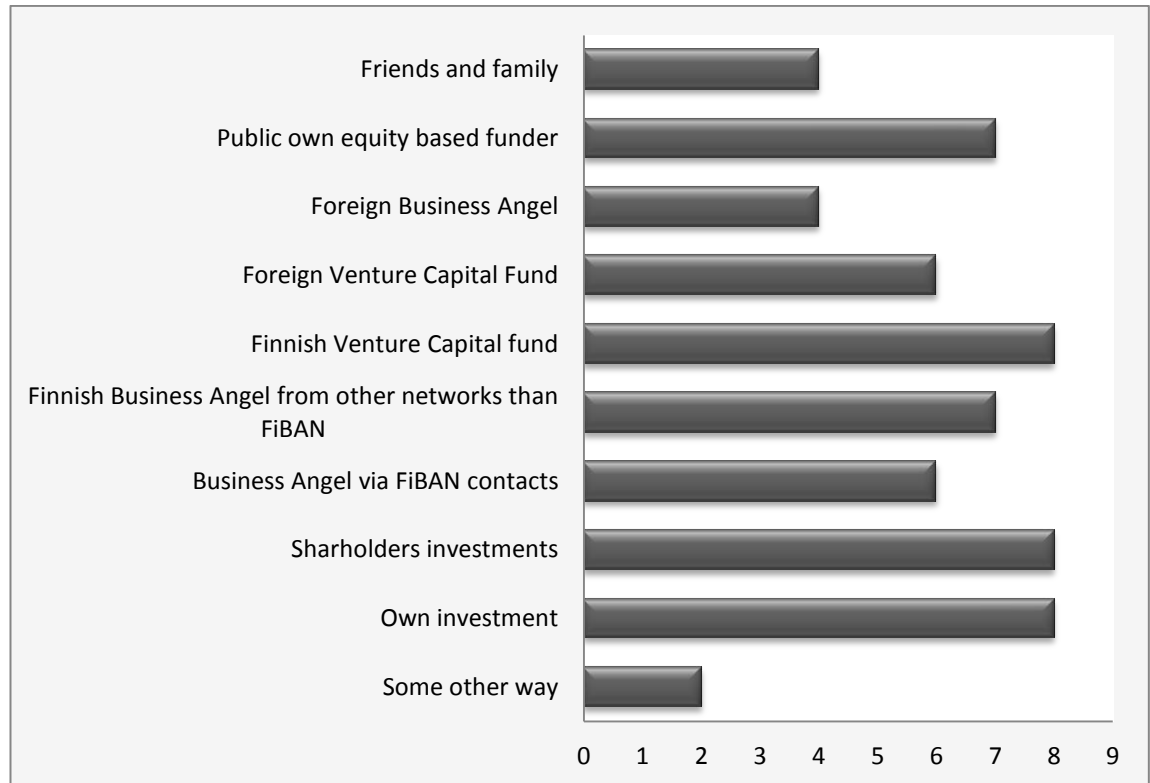


Figure 10: Sources of private equity funding

The companies would primarily get funding from own investment, shareholders investments and from a Finnish venture capital trust. It was surprising, that the entrepreneurs preferred equity from a VC investor rather than from a public source. Secondary option for private equity would be a public financier or a Finnish business angel, which was not in FiBAN's network. Private equity from friends, family and acquaintances was not so popular source, which was also surprising, as well as private equity from abroad. It seems, that even though startups are innovative and growth seeking, the so called born global attitude is not yet so widely adopted. I think the cultural base of the Finns is one factor influencing the small score of asking funding from friends and family. The following question dealt getting private equity from some other source. Two of the respondents stated private equity when quoted at the stock markets. This was excluded from the source list in question 9 as the purpose was more to study private equity funding before the startup company is enlisted.

The knowledge base towards the processes of private equity funding was important to know for the second research question.



Figure 11: Knowledge of private equity funding processes

Most of the respondents stated that they knew processes connected to private equity (83,3 %). The rest did not know. None of the respondents did not answer no, so from this can be concluded that everyone of the respondents would probably know at least some of the processes, even though they have not applied for private equity funding.

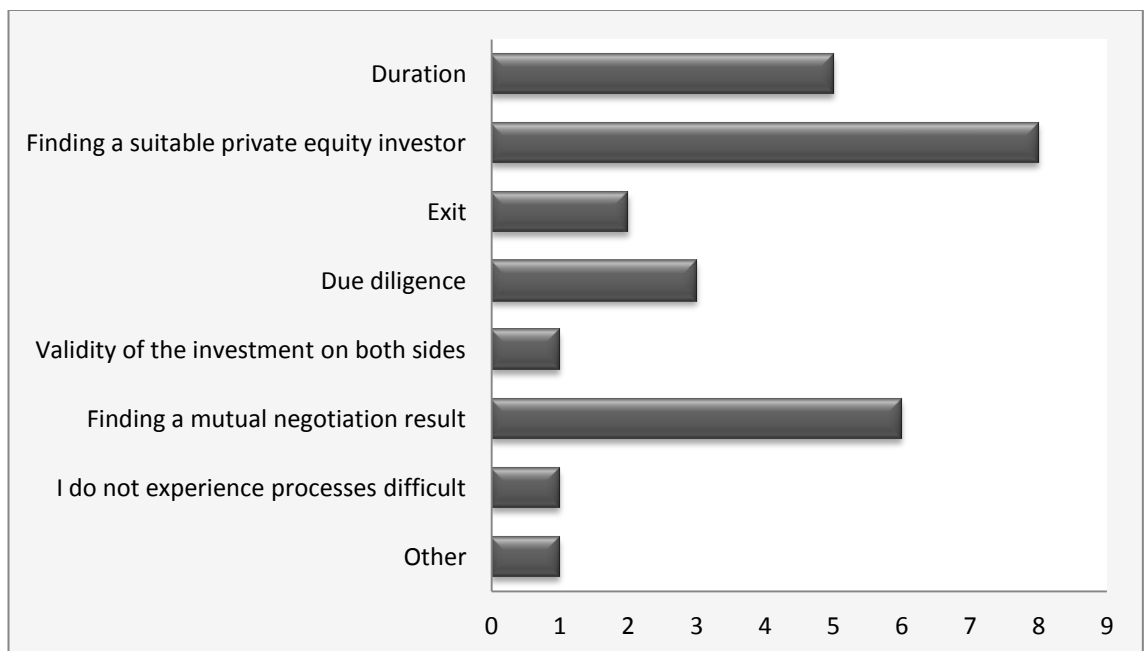


Figure 12: Most difficult part in the funding process

Finding a suitable private equity investor was considered to be the most difficult. The second was the negotiation process and finding a suitable result for both sides. Also the duration of the process was considered to be difficult. Only one company felt, that the processes were not difficult at all. This company although had not used external funding in their company at all.

Question 13 was an open question concerning other difficulties encountered in the process. The respondents felt frustrated mainly to finding a suitable investor:

“Finding the right investor and knowledge of what our company represents to them. The fact that we represent something new seems to be foreign to investors.”

“ Finnish investors and funds generally have small stakes. For bigger and more ambitious venture, the money should be gathered from abroad.”

“ The time resources it takes from something more important”

“ The possible (often more likely) removal of the founders from operative management.”

The respondents brought out really important facts. Finding an investor was considered to be difficult and specifically the right kind of investor. Processes require time and effort, which is away from doing the core business. Also the possibility that the founders could be replaced from the operative management left worries. The problems the process includes, was although not an insuperable obstacle to most of the entrepreneurs.

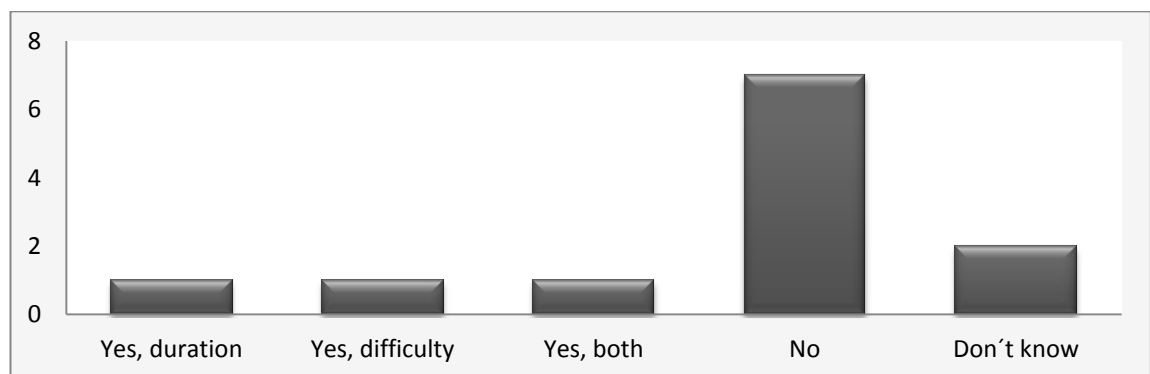


Figure 13: Duration and difficulties of the process being an obstacle

Most of the respondents would apply for private equity funding nevertheless the processes might be difficult and last for a long time. Three respondents considered these to be an obstacle quite equally. Two respondents could not answer the question.

In the theory base of the research, it was stated that for quick money, private equity funding was not the right way. For testing this theory, the survey contained a question about the length of the process.

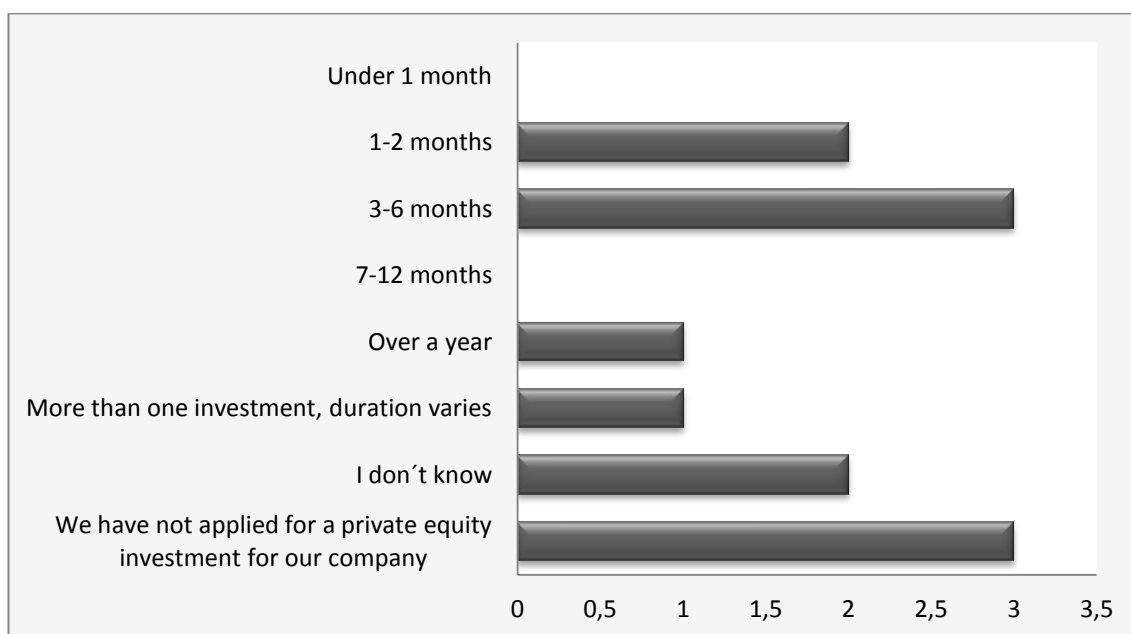


Figure 14: Duration of the process

The most common duration seemed to be three to six months. One company stated that the duration had been over one year.

Business angel is one way for receiving equity, and it is one potential financier especially in the seed stage of the company. Crossing the valley of death in the seed stage is crucial, so in the survey, questions about business angels were also included.

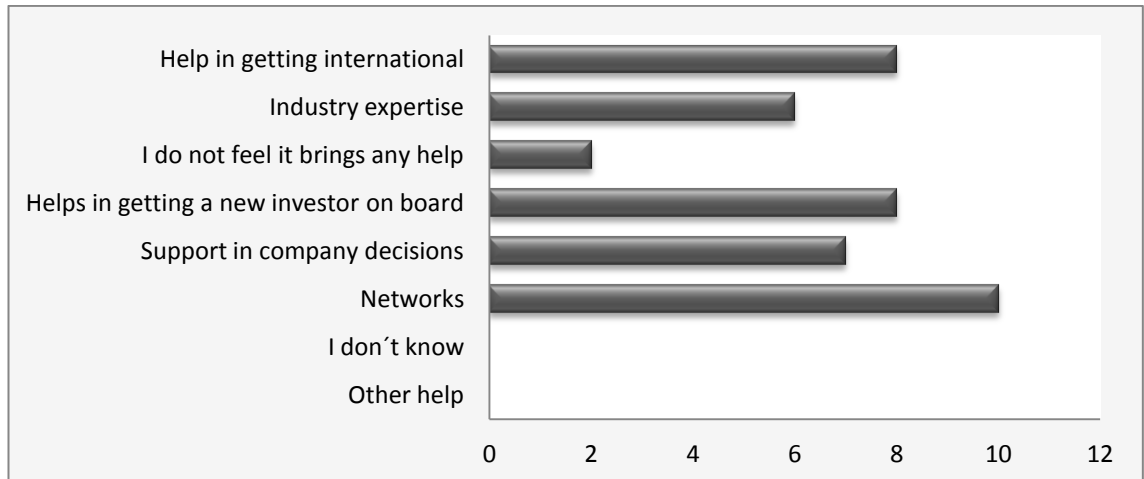


Figure 15: Benefits of a business angel

Networking seemed to be the most important benefit in having a business angel on board, secondary were assistance in going international and help to get another investor on board. According to responds, other possible benefits included mentoring. One respondent stated that there was not any significant business angels in their company industry, specialized venture capital investor could also bring them similar benefits.

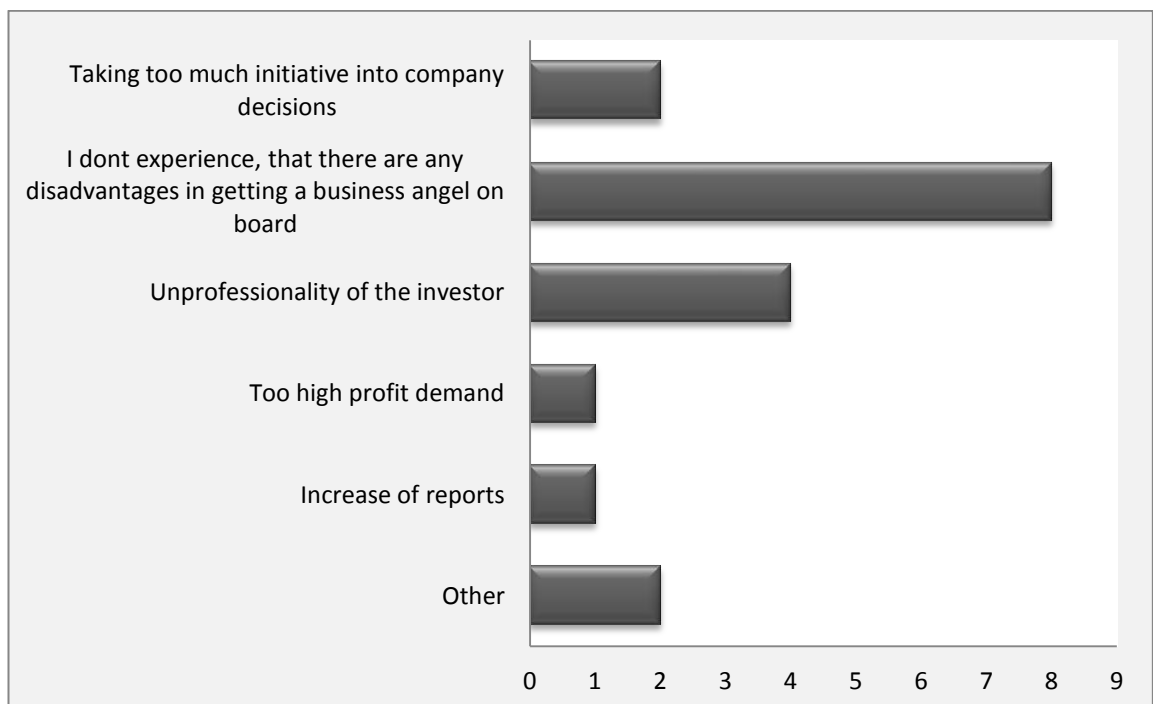


Figure 16: Disadvantages of a business angel

Most of the respondents did not feel that having a business angel on board would bring any disadvantages. One factor although brought up, as 33 % considered that unprofessionalism of the investor was one disadvantage. If the choice of the business angel goes wrong, the problems could follow a long time:

“Taking too much initiative to company decisions after a small investment and challenging the ownership takes a big part from the company energy”

“Wrong choice of a business angel leads to everything as above and everything else what a bad business partner can bring”.

7 CONCLUSIONS

Funding innovative companies and ideas is essential for the whole economy, and with the current economic state, it has become more and more important. Studying the startup companies opinions about the current situation is important for receiving the right picture and understanding better what needs to be improved. In the research made, the answer percentage was 24 % as 12 companies answered the survey. The results can only be considered to cover the attitudes of the respondents and only partly the attitudes of the Southwestern startup companies in this specific point in time.

For the first research question I had, *“how do startup companies in the Southwest Finland experience accessibility of private equity as a funding source from Finland and from abroad?”* , the results of the research were not so univocal. In total, half of the respondents experienced that receiving private equity from Finland was not easy. From this half, most had either applied for private equity investments without receiving it or hadn't applied for private equity investments at all. Those (33 %), who answered that it was easy to receive private equity investments, the background and experience was quite different as they had received investments or were considering for applying. The rest were not able to answer to the question. It was interesting to notice, that the most, who felt that private equity was not easily accessible in Finland, stated they had a good knowledge of private equity investments. On the opposite side, the previous knowledge base varied more from excellent to poor. From abroad, equity was not either wanted or known how to seek. This could be seen from the survey question 8, where most (66 %) of the respondents stated they did not know how easily private equity from abroad would be available. Some of these respondents were although ready to apply for an investment from a venture capital company or a business angel from abroad, so probably these specific companies lacked knowledge of getting an investment from abroad. Getting an investment from another country would most likely take the

company abroad and for some of the companies, this was not the direction they wanted.

The second research question I had in the beginning, was *“what kinds of processes are connected to finding and receiving private equity and how do entrepreneurs experience them?”* Majority of the respondents stated to know private equity funding processes from before. In general, the processes were felt difficult. Finding a suitable private equity investor felt the most difficult part. From the respondents comments, it seemed that they were a little bit frustrated. According to one entrepreneur, startup entrepreneurship was something new for the investors which led to the fact that finding an investor was difficult. Potential investors were not known and contacts were lacking. It was also mentioned, that Finnish investors and funds usually play with small stakes, so for bigger investments, investments from abroad were a necessity. The length and difficulty of the processes were although not an obstacle for applying and searching for private equity in minds of the majority of the companies.

When examining the results of the research, it can be analysed that room for improvement exists in the accessibility of private equity in Finland and abroad. Information of private equity investors and investments from abroad should be more available. Finding a suitable private equity investor felt problematic to most of the respondents; perhaps better networking possibilities and matching events with potential investors should be organized more. It seemed that public funding and equity were quite well available for startup entrepreneurs which was really good. The government could although offer more support mechanisms for the VC investors and business angels.

It would be interesting to do a follow up survey a few years from now for comparison of the changed attitudes. One suggestion for a follow up research would be studying more closely private equity funding from abroad.

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Survey

1. Company industry? *

- Manufacturing
- Transportation and storage
- Construction
- Accommodation and food service activities
- Funding and insurance
- Real estate
- Human health and social work activities
- Bio industry
- Electricity,
gas, steam and air conditioning supply
- Administrative and support
service activities
- Arts, entertainment and recreation
- Information and communication
- Other service activities
- Agriculture, forestry and fishing
- Water supply; sewerage, waste management and
remediation activities
- Professional, scientific and technical activities
- Sea industry
- Other industry

2. Company size? *

- 1-3
- 4-10
- 11-20

- 21-50
- 51-100
- Over 100

3. Have you used external funding in your company? *

- Yes
- No
- I don't know

4. How would you describe your knowledge of own equity term based funding?

5. Has your company applied own equity term based funding from a business angel or from a venture capital trust? *

- Yes, and also receiving it within the last 12 months
- Yes, and also received it. Not within the last 12 months
- Yes, without receiving it
- Yes, the process is still unfinished
- No
- No, but we have been planning to apply
- I don't know

6. Has your company applied for own equity term based funding from a public source? By this is meant scholars and equity investments, excluding company loans. *

- Yes, and also receiving it within the last 12 months
- Yes, and also received it. Not within the last 12 months
- Yes, without receiving it
- Yes, the process is still unfinished
- No, but we have been planning to apply
- No
- I don't know

7. Do you experience, that own equity term based funding is easily accessed in Finland *

- Yes
- No
- I don't know

8. Do you experience, that own equity term based funding is easily accessed abroad? *

- Yes
- No
- I don't know

9. From where would you get own equity term based funding for your company?*

- Friends and family
- Own investment
- Shareholders investments
- Business Angel via FiBAN contacts
- Finnish Business Angel from other networks than FiBAN
- Finnish Venture Capital fund
- Foreign Venture Capital Fund
- Foreign Business Angel
- Public own equity term based funder
- Some other way

10. In case you get own equity term based funding via some other way, from where would you get it?

11. Do you know the processes connected to private equity funding? *

- Yes
- No
- I don't know

12. What part in specific do you consider difficult within private equity funding process? Answer as many as you wish. *

- Duration
- Finding a suitable private equity investor
- Finding a mutual negotiation result
- Validity of the investment on both sides
- Due diligence
- Exit
- I do not experience processes difficult
- Other

13. In case you consider something else to be more difficult concerning the private equity funding process, what would it be?

14. Do you experience, that length or difficulty of the process would prevent you from applying private equity funding? *

- Yes, duration
- Yes, difficulty
- Yes, both
- No

I don't know

15. How much time have you took preparing and negotiating in the funding process on average? *

Under 1 month

1 - 2 months

3 - 6 months

7 - 12 months

Over a year

More than one investment, duration varies

I don't know

We haven't applied for a private equity investment to our company

16. Besides the monetary assistance, what other benefits do you consider a business angel could bring? *

Help in getting international

Industry expertise

Networks

Support in company decisions

Help in getting a new investor on board

I do not feel it brings any help

I don't know

Other help

17. If you believe a business angel would bring some other benefits, what would they be?

18. What disadvantages do you think a business angel would bring? *

- Taking too much initiative to company decisions
- Increase of reports
- Too high profit demand
- Unprofessionality of the investor
- I don't experience, that there are any disadvantages in getting a business angel on board
- Other

19. In case you answered the previous question "other", what other disadvantages do you consider a business angel would bring?

Cover letter

Hello!

I am a near graduate business student at Turku School of Applied Sciences. I am doing my thesis on attitudes of Southwestern startup companies towards the accessibility and processes of private equity funding. For my thesis, I have created a survey which you can reach via a link at the bottom of this message. In case you are not the right person for answering the survey, I respectfully ask you to forward the message to a person who is a decision maker in your company finance.

With the help of the survey, an insight of the experiences and attitudes towards private equity funding is aimed to be created. The aim is to find out whether the companies experience, that own equity term based funding is easily accessed, how well the processes are known and are they considered to be difficult.

Your response will be dealt confidentially and anonymously. Based on the results, you cannot be identified. The research material will be used for only this thesis. Last date for your reply is on 15th May 2015.

Answer will take approximately 5 to 10 minutes. The results can be seen in form of a thesis from October 2015 in an electronic form, as well as a paper version in Turku School of Applied Sciences, Lemminkäisenkatu unit.

For enquiries concerning the research do not hesitate to contact me: katja.paivarinta@edu.turkuamk.fi.

Thank you for participating!

Katja Päivärinta,
business student
katja.paivarinta@edu.turkuamk.fi

Reminder letter

Hello!

Do you need a small brake to your day with an interesting survey?

This is a reminder to a survey sent a week ago. The survey aims to find out the attitudes of the southwestern startup companies towards the accessibility and processes of private equity term funding. It is a part of a thesis work made by a student at Turku School of Applied Sciences.

I would appreciate more responds for increasing the reliability of the research results. Last date for your reply is on 15th May 2015.

Best regards,

Katja Päivärinta

katja.paivarinta@edu.turkuamk.fi

Thank you letter

Hello,

The survey for accessibility and processes of private equity funding has been closed. Warm thanks for the responds!

Best regards

Katja Päivärinta

katja.paivarinta@edu.turkuamk.fi