

Comparative Analysis of Investment Criteria between Corporate Venture Capital Funds and Independent Venture Capital Funds in the DACH region

Nicolai Heinzmann

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Abstract

Title: Comparative Analysis of Investment Criteria between Corporate Venture Capital Funds and Independent Venture Capital Funds in the DACH region

Author: Nicolai Heinzmann

Keywords: Venture Capital, Investment Criteria, Strategic Alignment, Exit Scenario, Corporate Venture Capital Fund, Independent Venture Capital Fund, Entrepreneurship, Value-added Services

This master thesis presents a comparative analysis of investment criteria between Independent Venture Capital Funds (IVCs) and Corporate Venture Capital Funds (CVCs) in the DACH region that invest in software business models. The study explores three key areas following research questions: (1) the investment criteria with the highest importance for IVCs and CVCs, (2) the influence of the strategic fit of ventures for value-added services for the investment selection, and (3) preferences in terms of exit strategies that influence the initial investment decision-making of IVCs and CVCs.

Based on the literature and expert interviews, the study reveals that IVCs and CVCs emphasize the categories of the management team, product characteristics, market characteristics, and the financial situation to evaluate a venture for potential investment. However, the study suggests that both venture investors have different preferences. While both assign high importance to criteria of the category of the management team, IVCs and CVCs have a distinct focus on underlying factors like industry expertise, leadership abilities, and founding experience.

The results provide insights for founders seeking venture funding as a better understanding of funding preferences can help to identify investors who fit best. Moreover, the study highlights the implications of organizational objectives on the investment criteria of different types of VC investors, the impact of the strategic fit for value-added services, and the exit scenario on investment decision-making.

Abstrato

Título: Análise Comparativa dos Critérios de Investimento entre Fundos de Capital de Risco Corporativos e Fundos de Capital de Risco Independentes na região DACH

Autor: Nicolai Heinzmann

Palavras-chave: Capital de Risco, Critérios de Investimento, Alinhamento Estratégico, Cenário de Saída, Fundo de Capital de Risco Corporativo, Fundo de Capital de Risco Independente, Empreendedorismo, Serviços de Valor Acrescentado

Esta tese de mestrado oferece uma análise comparativa dos critérios de investimento entre os Fundos de Capital de Risco Independentes (IVC) e os Fundos de Capital de Risco Corporativos (CVC) na região DACH, com foco em modelos de negócio de software. O estudo aborda três áreas principais: os critérios de investimento mais relevantes para IVCs e CVCs, a influência do alinhamento estratégico das empresas em serviços de valor acrescentado na seleção do investimento, e as preferências em estratégias de saída que impactam as decisões de investimento iniciais.

Com base na análise de literatura e entrevistas a peritos, o estudo revela que tanto IVCs como CVCs priorizam as categorias de gestão de equipas, características de produto, condições de mercado e situação financeira ao avaliar uma empresa para investimento. No entanto, as preferências diferem entre os mesmos. Embora ambos valorizem a categoria de gestão de equipas, os IVCs e os CVCs focam-se em diferentes aspetos subjacentes como a experiência no setor, a capacidade de liderança e a experiência dos fundadores.

Os resultados fornecem informação para fundadores na procura de financiamento de risco, uma vez que uma melhor compreensão das preferências de financiamento pode ajudar a identificar os investidores mais adequados. Além disso, o estudo destaca as implicações dos objetivos organizacionais nos critérios de investimento de diferentes tipos de investidores de capital de risco, o impacto do alinhamento estratégico em serviços de valor e o cenário de saída na tomada de decisões de investimento.

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Glossary

Bn	-	Billion
CVC	-	Corporate Venture Capital Fund
DACH-	-	Abbreviation for Germany (D), Austria (A), Switzerland (CH) and Liechtenstein
ESG	-	Abbreviation for Environmental, Social and Governance
EU	-	European Union
EUR	-	Euro
GDP	-	Gross Domestic Product
IC	-	Investment Committee
IP	-	Intellectual Property
IPO	-	Initial Public Offering
IVC	-	Independent Venture Capital Fund
KPI	-	Key Performance Indicator
M&A	-	Mergers and Acquisitions
MIT	-	Massachusetts Institute of Technology
MM	-	Million
MVP	-	Minimal Viable Product
VC	-	Venture Capital
UK	-	United Kingdom
US	-	United States of America
USD	-	US Dollar
RBV	-	Resource Based View
ROI	-	Return on Invest

1 Introduction

1.1 Background and Problem Identification

Over the course of a decade, venture capital funds have established themselves as a driving force to enable entrepreneurs to realize and scale their ideas and foster innovation. Particularly in the DACH region, venture funding activities grew since 2013 from EUR 1.6Bn to its peak in 2021 of EUR 19.3Bn and slowed down in the following years due to global economic pressures (PitchBook, 2023). Germany remains the driving force within the region, with over 75% of the market capture. With the rising deal count, the venture funding ecosystem developed itself significantly. From solo venture capitalists with only one person managing funds with volumes around EUR 30MM to large international venture capital corporations with more than a billion Euros of assets under management invested to startups around the globe, shaping the ecosystem of the industry. The differences between venture capital financiers cannot only be measured in the amount of capital they are managing but also in structural and organizational terms.

Within this ecosystem, two distinct types of venture capital firms have emerged: Corporate Venture Capital Funds (CVCs) and Independent Venture Capital Funds (IVCs). CVCs backed by large corporations have typically aligned objectives with their parent organization. In contrast, IVCs receive their capital from several independent investors and allocate the funds in ventures with previously agreed target characteristics with a certain geographic scope and some requirements regarding the industry. While both types of venture capital investors have several factors in common they prefer to see during the evaluation of a venture, there are also a number of criteria that deviate (Rin et al., 2013).

As founders aim to position themselves in the best possible way to increase the likelihood of receiving venture funding, it is crucial to get a better understanding of the different preferences of these two types of venture capital funds (VCs). In the past, scholars have already analyzed single criteria very specifically without any comparison on a broader level on the impact of evaluation categories for the final funding decision of Corporate Venture Capital Funds and Independent Venture Capital Funds in the DACH region.

1.2 Objective of the Study

This master thesis aims to provide a better overview of funding preferences between Corporate Venture Capital Funds and Independent Venture Capital Funds. Previous literature provides insights into some of the topics, without covering comprehensively the perceived importance of the different characteristics in comparison to each other for these two types of VC investors in the DACH region. This master thesis intends to fill this gap and scrutinize some of the current research findings with a qualitative approach for a better understanding of the target startup profiles of CVCs and IVCs in the DACH region. To provide answers to this topic, this thesis is structured along the following research questions:

Q1: Which investment criteria are of the highest importance for IVCs and CVCs?

The first objective is to identify the main factors that venture capitalists evaluate to assess potential investment opportunities. Following the structure of Granz et al. (2020) and Eisele et al. (2011), this part will explore specifically the categories Management Team, Product Characteristics, Market Characteristics and the Financial traction among IVCs and CVCs. In addition, the study aims to rank these criteria in terms of the perceived importance from the perspective of the two investor types.

Q2: What instruments are CVCs and IVCs using in order to provide non-financial value-added services and how do these services impact their respective investment criteria?

As many venture capital funds utilize significant resources to support their portfolio startups post-investment, the second research question aims to analyze the different approaches of IVCs and CVCs in this regard. Further, the study provides some insights into whether strategic fit, i.e., the compatibility of startups to participate in programs of value-added services, impacts the perceived potential of the venture and serves, therefore, also as an additional investment criterion.

Q3: How do exit strategy preferences differ between IVCs and CVCs?

Since a successful exit often marks the ultimate goal for venture capital investors, this research question addresses the perceived importance of a promising exit scenario at the time of the initial investment. Moreover, potential differences in evaluating this criterion are investigated between IVCs and CVCs with additional findings on the possible underlying reasons.

1.3 Structure and Preview

This master thesis is structured into six main chapters. The current state of research on this topic is outlined in the first part, the literature review. This chapter also provides the fundamental knowledge to enable the reader to contextualize the findings correctly. Therefore, topics like the funding life cycle and the venture capital ecosystem in the DACH region are presented at first. In addition, theoretical frameworks applicable to venture capital investing are outlined as an approach to explain the different behavior of CVCs and IVCs in a later chapter. The literature review further presents the typical process of venture selection and general investment criteria, based on major research milestones. In addition, the latest research findings on differences in terms of investment criteria between IVCs and CVCs were displayed in order to build a knowledge base for the results and discussion in the following chapters of this master thesis. This master thesis is based on qualitative interviews with both IVCs and CVCs to get insights into the respective investment preferences. Following the deductive approach of Mayring (2010), these results were coded according to pre-defined themes and compared with the previously outlined state of research. The final conclusion provides a summary as well as links for future research.

2 Literature Review

The following literature review is divided into six parts and will provide a general understanding of startup financing, the involved entities as well as the investment processes according to the latest findings of scientific finance and management literature. The first part gives a general overview of venture capital financing within the DACH area and insights about the funding lifecycle. Afterwards, the second part provides theoretical perspectives on venture capital and evidence from the literature about applicable frameworks towards the overall topic. The third part presents strategic and organizational structures for both Independent Venture Capital Funds and Corporate Venture Capital Funds. The next chapters explain the process of VC funds to select investments, elaborate on investment criteria in general and display the current state of literature on differences in investment behavior between Independent Venture Capital Funds and Corporate Venture Capital Funds.

2.1 Venture Capital Funding in the DACH Area

The first part of the following literature review provides a brief overview of available startup funding options along the lifecycle according to the current state of management literature, with a special focus on the German-speaking area, the DACH market. Additionally, this section explains the general structure and characteristics of the venture capital ecosystem and its latest development. The presented literature includes both major research milestones from the past as well as current publications to display the latest findings.

2.1.1 Investing along the Startup Life Cycle

The scientific management literature offers various approaches to categorizing startups in certain development stages. Studies from the late 20th century, like Churchill and Lewis (1983), made one of the first attempts to determine the state of startups by introducing multidimensional models. Nevertheless, these models focused solely on the internal characteristics of the firm without considering market factors like revenues and customers. In 2001, Schmeisser focused on the specifics of the development stages in the German startup ecosystem. With additional dimensions of required milestones and investors along the lifecycle, Eisele et al. (2011) published a more sophisticated model that connects development stages with investor expectations and funding round requirements. Since the investor's ecosystem and startup

classification models within the DACH area are significantly influenced by the US market and its origin of venture financing Besanceney (2021), the following chapter merges the findings of Eisele et al. (2011) and Schmeisser (2001) with international publications of Gallo and Verdoliva (2022), Damodaran (2009) and others.

Overall, the lifecycle of startups can be structured in the following four stages: Early Stage, Growth and Late Stage as well as the Maturity Stage. Since startups evolve already significantly within these four broader stages, this chapter connects the funding phases Pre-Seed, Seed, Series A, Series B & C, Series D+ and different exit scenarios to the broader stages to provide a more sophisticated overview. Each phase allows founders to approach different types of capital providers since their ventures' characteristics and risk profiles change and attract different investors over time. In addition to the funding opportunities in each phase, this chapter delivers a concise review of important milestones that founders need to achieve for their ventures to reach the next stages within the lifecycle.

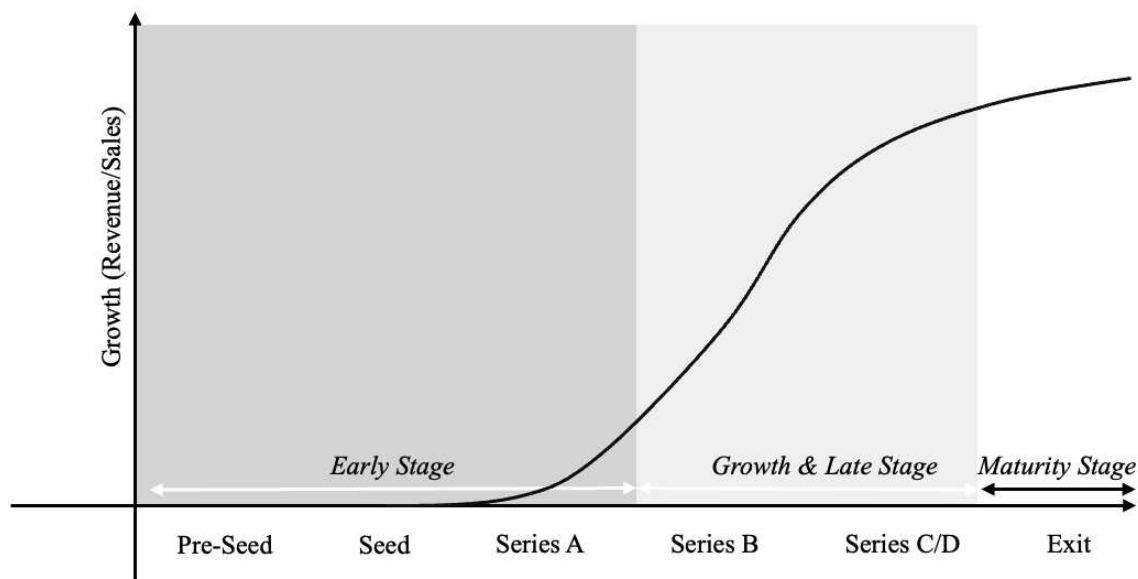


Figure 1: Start Funding Lifecycle; adapted from Gallo and Verdoliva (2022), Schmeisser (2001) and Damodaran (2009)

The earliest phase within the lifecycle of startups is called the Pre-seed Stage. At this point, founders mainly work on the initial concept, validate their idea with market research, and create the business model (Jáki & Molnár, 2021). They further establish a cohesive founding team that ideally covers already the required skills in a complementary way but also conducts first activities to strengthen the network and build relationships with partners (Rasmussen & Sørheim, 2012). Startups usually work on developing the so-called Minimal Viable Product

(MVP) at this stage, which offers a basic set of necessary product features to gather validated learnings from early customers with the lowest possible effort and resources (Duc & Abrahamsson, 2016). At the pre-seed stage, the main sources of financing are bootstrapping and personal savings (Cumming & Johan, 2009), support from friends and family (Jáki & Molnár, 2021) and governmental grants (Rasmussen & Sørheim, 2012). However, according to Jáki & Molnár (2021), it is nearly impossible to raise external funding from private entities during this stage since the startup does not have any track record at this point. The only exception applies in rare cases to serial founders who have already proven their ability to build new ventures successfully (Annamalaisami, 2021).

The subsequent phase of the startup funding lifecycle is called the Seed Stage. At this point, founders have usually already completed the development of the MVP and focus more on improving the product, taking into consideration the feedback of early customers. Moreover, they extend the market research by engaging in customer interviews, pilot testing and data analysis with quick iterations of product updates. At this point, the product market fit is usually not finalized (Y-Combinator, 2024). Depending on the business model and the industry, some startups might already have first revenues. During this stage, startups typically acquire funding through business angels, product crowdfunding¹, public grants (Klingler-Vidra, 2016) and accelerators (Yu, 2019) . In recent years, an increasing number of venture capital funds also started to invest in earlier phases than usual, already participating in Seed rounds (Y-Combinator, 2024). Investments at this point can be associated with very high risk as the likelihood that a startup is successfully qualifying for the next stage, so-called Series A, is around 30% (Teare, 2022) . In particular, founders need to be able to demonstrate a validated product-market fit (Gallo & Verdoliva, 2022) as well as a working revenue model with substantial sales, especially if they are operating in the software industry (Klingler-Vidra, 2016). Series A funding rounds, where several investors typically decide together on the deal and its terms, usually range from a few million² to tens of millions³. According to the startup data platform Crunchbase, the average amount of Series A rounds in 2022 was around 19.8 mm USD (Teare, 2022). At this point, Venture Capital funds (VCs) are the primary funding source of startups, often leading the deal rounds and setting conditions for other investors (Goldfarb et al., 2013). While more common in the seed stage, Angel investors also participate at times in

¹ Product crowdfunding: In return for funding, a startup offers a product still in the development stage (Elia & Quarta, 2020).

² In USD.

³ In USD.

Series A funding rounds if they have a very strong belief in the business to avoid dilution, given the disposal of the appropriate financial resources. During the entire Early Stage, debt funding is usually unavailable for startups since they are often not cash-flow-positive at this point, which would even aggravate their situation through the nature of further payment obligations for interests and increasing losses (Eisele et al., 2011).

The subsequent Series B and C stages symbolize the transition from the Early Stage (Seed & Series A) to the start of the Growth Stage (Gallo & Verdoliva, 2022). In order to qualify for funding rounds at this stage, startups need to have completed the product development with a successful market entry and preferably strong growth rates. Key personnel is supposed to be hired and the company should have solid organizational structures as the basis in order to be able to go the expected next steps. Startups typically already have a proven and consistent acquisition strategy and a large customer base with the ability to grow 2x year over year (Finmark, 2023). Series B funding has a large range of round sizes with a median of 25 mm USD in 2023 (Glasner, 2023) . Large outliers, as seen with the German biotech company BioNTech, which received around 325mm USD in 2019 (BioNTech, 2019), are more frequent in this phase than in previous stages. Typical investor groups are VCs, private equity firms, pension funds, family offices and other asset management entities. In addition, several startups become profitable and cashflow-positive during this phase, enabling them to leverage funding rounds with debt as well (Eisele et al., 2011). Overall, startups utilize the funds to scale up their operations, expand into new markets, and sometimes to diversify their product portfolio (Eisele et al., 2011). Growth rounds such as Series B and C are also often publicly announced on various media channels, highlighting round sizes and anchor investors (Y-Combinator, 2024). Startups of the following later stages in Series D+ are characterized by high numbers of employees ranging from hundreds to thousands (Y-Combinator, 2024), depending on the business model. Additionally, investors face smaller risks at this point since the company is already established in one or several markets and has a financially sustainable business model, allowing analysts to make more precise evaluations and forecasts. According to Gallo & Verdoliva (2022), transactions at this point typically have a higher complexity for new investors because of the involvement of stakeholders and conflicting interests. Due to higher funding needs, private equity firms, debt providers as well as corporate and institutional investors are the main providers of capital at this stage (Gallo & Verdoliva, 2022). Since these groups have deviating risks and return opportunities, their expectations vary significantly. According to the literature, especially private equity investors tend to support startups actively by either pursuing internal or external growth (Gallo & Verdoliva, 2022).

Once a company enters the mature stage, its growth is already steady but not as steep as in previous stages (Damodaran, 2009). At this point, investors mainly face market risk since the company's business model is booming, cash flows and profitability are increasing on a stable level (Gallo & Verdoliva, 2022). When challenges arise in the mature stage of the company, they are usually rooted in management issues that need to be addressed (Gallo & Verdoliva, 2022). Research highlights that especially founder-CEOs are less effective for mature organizations since they often lack the necessary managerial skills to navigate the complex bureaucracy (Abebe & Anthony, 2013). For better access to capital markets, some companies decide to go public by offering shares on a stock exchange, the so-called initial public offering (Damodaran, 2009). While this funding mechanism can provide significant capital, it comes with high regulatory compliance and market exposure. Alternatively, companies can also secure equity funding with private equity investments, transactions with strategic investors, secondary sales or mergers and acquisitions (Damodaran, 2009; Gallo & Verdoliva, 2022). In addition to equity financing, companies leverage their funding needs through a variety of debt instruments as well.

2.1.2 Venture Capital Ecosystem in the DACH Region

The following chapter provides an overview of the origin of venture capital investing as described in management literature. Additionally, the characteristics and cultural differences of the DACH VC market compared to other European regions and the US are explored based on researched phenomena from literature and recent developments by industry reports to present an actual image of the ecosystem.

The roots of modern venture capital investing originated in the 1970s, when Georges Doriot and Karl Compton, president of MIT⁴, founded the American Research and Development Corporation to invest in companies with high growth potential, particularly those funded by returning soldiers of the Second World War (Hsu & Kenney, 2005). Over the next decades, venture capital evolved from a philanthropic activity to a commercial industry, mainly driven by the upcoming technological boom of electronics and software in the San Francisco Bay Area (Murthy, 1999). At the same time, large corporations started own venture capital subsidiaries, primarily driven to participate at the success of this new trend and for corporate diversification

⁴ Massachusetts Institute of Technology

(Dushnitsky, 2012). The industry grew quickly on a global scale and reached Europe in the following years. A combination of local entrepreneurship and the adaption of the U.S. model usually drove the development of venture capital ecosystems worldwide (Lee & Wong, 2004). The industry was primarily established in the DACH⁵ region in the early 1990s due to government interventions that kickstarted the first investments in high-tech industries (Avnimelech et al., 2010). Fueled by the dot-com boom in the 2000s, the venture capital ecosystem grew more rapidly in Europe and DACH. The industry shifted in this time from public towards private involvement, also with initiatives of banks, pension funds, family offices and other institutions (Grilli & Murtinu, 2014). At this time, corporate venture capital (CVC) activities peaked, accounting for approximately one-quarter of all global deals (Dushnitsky, 2012). Since the 2000s, the overall venture capital ecosystem in the DACH area has developed into one of the main global hubs for startup financing. With accumulated more than EUR 237bn of assets under management of regionally headquartered investors, the DACH region is the second largest VC market in Europe after the UK & Ireland, with around EUR 471bn (i5Growth et al., 2022). The Benelux countries have a higher concentration of private equity firms than venture capital companies and have the third-biggest market with regional investors sizing accumulated EUR 189bn in assets under management (i5Growth et al., 2022). Within the DACH region, Venture Capitalists and Private Equity investors are mainly concentrated in the cities of Berlin, Munich, and Zurich.

The characteristics of Venture Capital ecosystems vary significantly depending on the economical area, influenced by political fundamentals and cultural differences. In comparison with the US, European VCs outperformed significantly in terms of size and performance. The International Monetary Fund reported that European venture capital investments averaged 0.3 percent of GDP 6 per year over the last decade, less than one-third of the US average (Arnold et al., 2024). The bank-based structure of the EU's financial system, especially within the DACH area, fragmentation of the economic and taxation system as well as less liquidity in the markets can be seen as major drivers of lower investments (Arnold et al., 2024). Refinancing by insurance companies, pension funds and an overall increased willingness among US households to take higher investment risks has led to constant higher capital access. In contrast, venture capitalists in the DACH region always needed to rely on smaller funding amounts from corporations and banks. Studies of Ooghe et al. (1991) and Schwienbacher (2005) argue further with an outperformance of US funds compared to EU VC funds, based on a higher risk appetite

⁵ DACH – Abbreviation for Germany (D), Austria (A), Switzerland (CH) and Liechtenstein (i5Growth et al., 2022).

coupled with more mature market structures, a constant level of high liquidity as well as a more substantial secondary market for exits. According to the European Capital Report, especially VCs headquartered in the DACH region have a significantly higher risk-averseness than other EU areas, but especially in relation to US VCs (i5Growth et al., 2022). Consequently, VC funds headquartered in DACH are more focused on investing in growth and later stages than investors from the UK, Netherlands or the US (i5Growth et al., 2022).

The current global economic downturn has highly impacted the recent development of the DACH VC market. Since a peak of VC investments between Q3 in 2021 and Q2 in 2022, where the market set records in deal counts and deal volume, both categories declined by more than 50% until the third quarter of 2023 (PitchBook, 2024). The market is further shaped by dragging exit valuations and a clear preference to mergers and acquisitions (M&A) transactions as compared to initial public offerings (IPOs) (PitchBook, 2024). Especially strategic acquirers stabilize the number of mid-market transactions as they are responsible for over 80% of the deals in 2023 (Clipperton, 2023). As still one of the most dominant industries with around 40% of the overall VC funding in DACH (Clipperton, 2023), software and cloud lost the most share of deal value, opposed by commercial products and services with the most increase in that time (PitchBook, 2024). Despite the downfall in several categories over the last years, the VC ecosystem of the DACH region has proven to be the most robust in terms of fundraising compared to all other regions in Europe which underlines its dominant role (PitchBook, 2024). Overall, the industry-leading data platform Pitchbook predicts in their annual report for the venture capital ecosystem ongoing challenges for 2024 through more demanding economic circumstances based on higher costs of capital, less leverage and tough exit conditions (PitchBook, 2024).

2.2 Theoretical perspectives on venture capital

The academic literacy offers various theoretical frameworks that are applicable to both independent venture capital funds and corporate venture capital funds, helping to explain their behavior and relationship to startups and founders. The so-called Principal Agent Theory is of special importance for this topic as it has high applicability for investment criteria and contractual regulations with the goal of minimizing investor risks and information asymmetries. The theory is generally originated in the field of economics and was further developed in

management science by Jensen and Meckling in their paper “Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure” in 1976. They address the challenges arising from the separation of ownership and management control in organizational structures. The primary concern is that agents potentially act in their own interests rather than those of the principal due to information asymmetry and different objectives since all parties are expected to behave rationally, risk-averse, and selfish (Jensen & Meckling, 1976). Applied to the topic of this thesis, venture capital funds act as principals that provide capital to startups, the agents that use the funds to improve operations and foster growth. As noted by Stiglitz and Weiss (1981), it is commonly assumed that entrepreneurs possess greater knowledge about the project than the investor (Cumming, 2012). According to the theory, it is likely that the agent (startup) will not necessarily act in the optimal interest of the principal (venture capital fund) if both parties aim for maximization of their goals (Jensen & Meckling, 1976). But also, in the case of CVCs that must balance strategic goals with financial returns, this dual focus can create conflicts if the startup diverges too much from the parent company’s strategy. Overall, the literature differentiates two types of agency theory issues based on the underlying information asymmetry, adverse selection and moral hazard.

Adverse selection is a problem that can appear before the transaction, leading the principal to close the transaction with an undesirable agent (Jensen & Meckling, 1976). The information asymmetry can be even increased by misrepresentations of the agent, overstating the potential or hiding risks in order to secure a contract. Specifically applied to the field of venture capital investing, an investment decision might be influenced by overly optimistic expectations of the founder, without being able to assess the real value of the startup.

The issue of moral hazard appears after the transaction in case the agent has incentives to take actions that are not ideal for the principal due to a lack of monitoring. According to Jensen & Meckling (1976), this behavior can be observed through hidden actions or risky behavior in situations when the principal bears some or all the consequences. With the acquisition of equity by the venture capitalists, founders might act riskier since they do not face the full potential of losses anymore.

In addition to agency problems, the theory of path dependency by Paul A. David (1985) and further developed by Sydow et al. (2020) is frequently cited in the field of finance, particularly in relation to the selection of investment criteria. The theory suggests that established practices and historic events are highly important for present decisions, ultimately leading to a lock-in where alternative courses of action are no longer viable (Sydow et al., 2020). Synergies,

efficiency gains through established mechanisms and learning effects from repetitive actions serve as a self-perpetuating mechanism, making deviations from the pathway even less attractive (Arthur, 1989). Furthermore, the authors argue that the decision to go for a certain path usually requires significant investments that can lead to substantial barriers preventing flexibility for a shift into other directions (Sydow et al., 2020).

By applying the notion of path dependence to venture capital, it becomes evident that VC firms might become entrenched in particular investing methods or industries due to past achievements. While the increasing experience in one field leads to more sophisticated evaluations of new investment opportunities, firms face challenges in pivoting to other potentially even more lucrative fields due to learning and coordination effects.

Besides the principal-agent theory and path dependency, the literature on entrepreneurial finance has greatly emphasized the concept of the so-called Resource Based View (RBV). Once developed by Jay Barney in 1991, the theory claims that a firm's competitive advantage is based on its unique resources and capabilities (J. Barney, 1991). These individual strengths must be valuable, rare, inimitable, and non-substitutable (J. B. Barney & Hesterly, 2012). Several examples from the literature underscore the high relevance of RBV to the venture capital field. Following the thoughts of Nadeau (2010), the concept can be applied by focusing on how VCs select and support their portfolio of startups with unique resources to support them on their way to achieve a competitive advantage. Moreover, Lockett & Wright (2001) add that especially the phenomenon of syndicated funding rounds with other VC partners leverages their ability to contribute with non-financial resources like network access and expertise towards a competitive advantage of the startup. For CVCs, the support of the resource base could work both ways since the parent company can also benefit from the innovative resources of the venture. Furthermore, Nadeau (2011) explains how technological innovations, considered as strategic resources, improve the exit performance of VC-backed companies leading to a higher likelihood of successful IPOs of startups that protect innovations with intellectual property (IP).

2.3 Organizational and Strategic Approaches of IVCs and CVCs

According to Rin et al. (2013), the literature on venture capital investments is usually divided into three main research streams: (1) The interaction of venture capital funds and its investors, (2) the organization of VC firms, and (3) the relationship of VC funds with their ventures following topics like investment criteria, the deal flow and exit scenarios. This chapter will provide an overview of the first two topics, focusing on the operational and governance structures of Independent Venture Capital Funds (IVCs) and Corporate Venture Capital Funds (CVCs). Additionally, insights from the literature of strategic approaches about each of the two VC types will be outlined as an important foundation to understand the differences in investment behavior that is presented in chapter 2.6.

2.3.1 Independent Venture Capital Funds

In order to understand different types and approaches to venture capital investing, it is essential to learn about the general structure and involved stakeholders of VC funds first. Since the literature usually refers to the investment activities of Independent Venture Capital Funds (IVCs), if not explicitly phrased out, this chapter will present the mechanism and structure following the general literature of VC governance to exemplify the processes of IVCs.

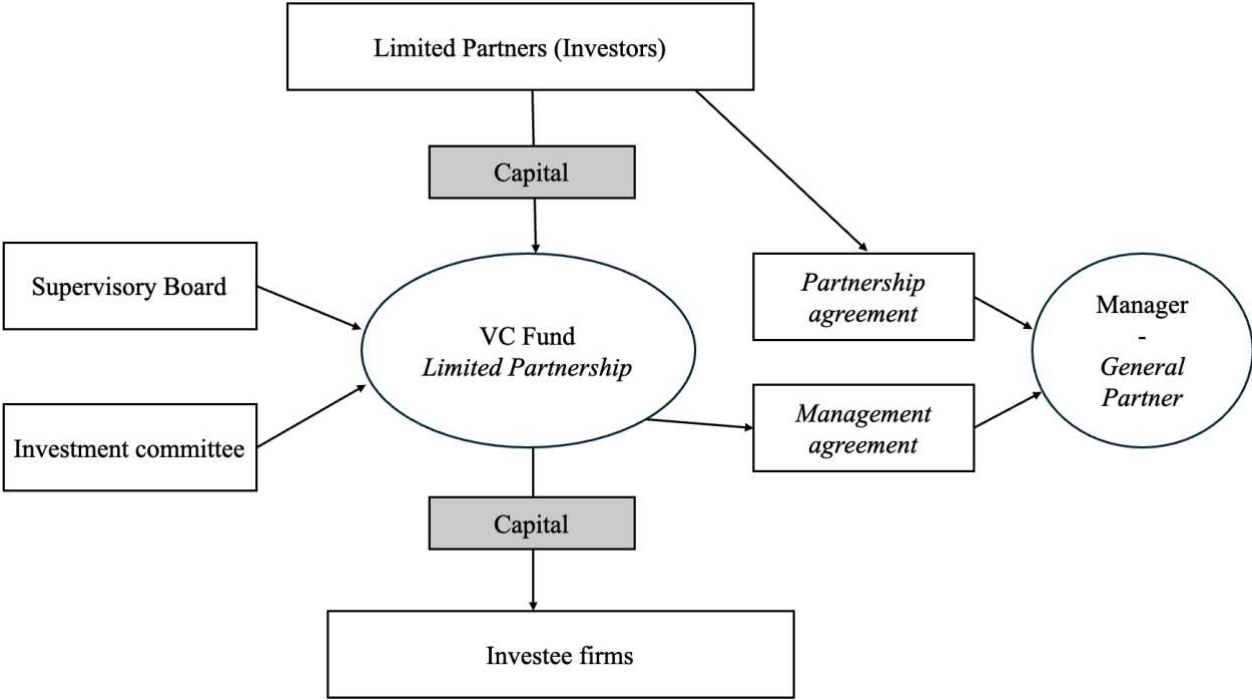


Figure 2: Governance Structure of a VC Fund adapted by Klonowski (2012)

Venture capital firms are predominantly structured with the contractual framework of limited partnerships, including two types of partners: limited partners as investors and the general partner who operates the fund (Walls, 2023). The capital for IVC investments is raised from a number of independent Limited Partners (LPs), consisting of wealthy individuals and institutional investors who are only liable for the capital they invested and receive a share of the fund in return (Rin et al., 2013). They are usually not actively involved in the daily business of the VC and receive periodic reports about the current activity and performance of the fund. The so-called General Partner, the VC management firm that is responsible for the day-to-day management of the fund, is also expected to invest a meaningful amount (usually around 1% of the VC funds' assets under management) to underline its commitment and create a structure of shared goals between the LPs and the GP (Klonowski, 2012). As presented in Figure 2, there are two types of agreements: the partnership agreement and the management agreement. The first displays the contractual settlement of the GP's compensation and general terms between the two parties (Klonowski, 2012). The latter structures the obligations of the investment committee (IC) and the supervisory board.

The investment committee (IC) serves as the fund's decision-making body to approve investment decisions based on information and recommendations provided by the GP (Klonowski, 2012). In this function, the IC also allows the fund manager to move a promising venture to the next stage of the investment selection process and challenge the GP by pointing out critical aspects of the venture (Walls, 2023).

The supervisory board, often consisting of representatives of the LPs, observes the financial and legal aspects of the VC. Depending on the structure of the VC, the supervisory board might also have the authority to make decisions. It also serves with advise for strategical matters as well as other topics like cash-flow management or recruiting important staff members (Klonowski, 2012). In order to guarantee a careful process of venture investment selection, investors expect the fund management to provide comprehensive documentation both the IC and the supervisory board (Klonowski, 2012).

Regarding the compensation, the general partner benefits from the management fee to cover operational costs (ranging from 1% to 2.5% annually of the committed capital) and the carried interest, a performance-based income that becomes payable after the LPs are repaid with their initial investment and a pre-defined minimum rate of return, the so-called hurdle rate (Rin et al., 2013; Walls, 2023). Scholars could prove that historic fund performance is one of the key variables that enables IVCs to raise new funds (Groh & von Liechtenstein, 2011; Hellmann &

Puri, 2002). Therefore, the carried interest, increased reputation and easier access to future investors are the primary motivational drivers for GPs (Groh & von Liechtenstein, 2011).

Overall, independent VCs are usually set up to invest actively over 3-4 years with an additional 3-6 years of harvesting and participating in follow-on investments (Walls, 2023). Several funds offer their portfolio ventures non-financial value-added services. These services usually range from consulting services over network access to active support for exits.

The previously presented services after the investment aim to support the portfolio firms to survive and grow ideally until they reach an exit. Exits, also known as liquidation events, typically appear as one of the following scenarios: (1) Share Purchase, (2) Strategic Acquisition (M&A), or (3) an Initial Public Offering (IPO) (Walls, 2023).

Several structural aspects of the IVC are translated into the fund strategy that typically aims to achieve the best possible financial performance in a pre-defined industry (Groh & von Liechtenstein, 2011). In order to ensure that the investments are well-aligned with the strategy, venture capital funds utilize so-called eligibility criteria that are further explained in chapter 2.4.

2.3.2 Corporate Venture Capital Funds

In distinction to other corporate activities with quite similar expressions but different meanings like “corporate venturing”, Dushnitsky (2012) introduced three characteristics that always apply to corporate venture capital funds and set them apart from other innovation initiatives: (1) CVCs always follow strategic objectives besides financial goals. (2) Ventures that receive funding are privately owned and maintain their legal independence from the investing corporation. (3) The investor secures a minority equity share of the venture.

Unlike the previously analyzed structure of IVCs that usually form limited partnerships, scholars found that Corporate Venture Capital Funds are organized quite heterogeneously (Dushnitsky, 2012). The first aspect that differentiates CVCs from each other is the question of direct vs. indirect engagement (Frey & Kanbach, 2023). Indirect investments of CVCs are conducted through funds of IVCs and do not require own specific organizational designs (Frey & Kanbach, 2023). Since the main process of venture investing is not managed by the CVC in the case of this indirect approach, this chapter will focus primarily on direct CVC investments.

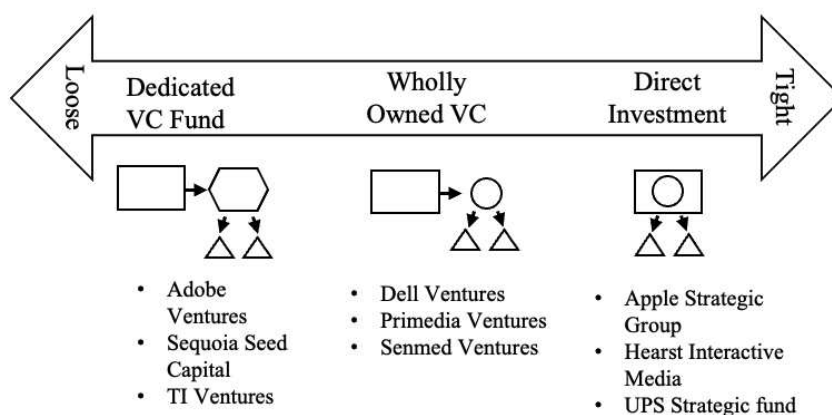


Figure 3: Organizational Structures of CVCs adapted from Dushnitsky (2012)

Reviewing the major studies on this topic by Hill and Birkinshaw (2008), Dushnitsky (2012), Siegel et al. (1988) as well as Frey and Kanbach (2023), CVC structures for a direct investment approach can be categorized into three different types: (1) Direct investment managed within a business unit of the parent organization, (2) entirely owned subsidiaries of the parent organization, and (3) a joint venture fund that is managed by a CVC and an IVC together.

(1) The first structure is closely embedded in the corporate environment without or very low information asymmetries and usually operates with a single, multiple, or portfolio investment approach (Frey & Kanbach, 2023). CVCs within a business unit are organized similarly to other units of the corporation and can be characterized with the same decision hierarchies and corporate values as the overall organization.

(2) The most common type of CVC is structured as a legal entity but entirely owned by the parent organization as a subsidiary (Frey & Kanbach, 2023) These organizations are usually only created for the purpose of venture investing, often with a strategic mandate regarding the target industry to invest in. This organizational type of CVC is generally structured in a very similar way to the previously presented ICV structure (Figure 2). Instead of a group of different limited partners, the parent corporation is often the only provider of the fund's capital. Google Ventures and Microsoft's M12 fund are best-practice examples of this organizational structure within the software industry.

(3) The joint venture structure with a dedicated fund, a relatively uncommon model, is co-managed by the corporation and an IVC. It is also based on the general structure, as presented in Figure 2. Still, there are two significant differences: The CVC operates as the only limited partner, whereas an IVC (independent of the parent organization) fulfills the entire or shared responsibilities of a general partner (Dushnitsky, 2012). A well-known example of the past

within the software industry is the collaboration of Sequoia Capital and Cisco (Frey & Kanbach, 2023).

As the second CVC structure (2), characterized as an entirely owned subsidiary, represents the most prevalent organizational model, all subsequent discussions and analyses of CVCs will focus on this particular structure.

Another essential factor that impacts the organizational processes of corporate venture capital funds is the level of autonomy they have toward their parent corporation, both in terms of decision-making as well as the allocation of capital. According to the studies of Siegel et al. (1988) and recent findings by (Frey & Kanbach, 2023), the majority of CVCs require formal approval by the corporate parent organization to proceed with ventures to the next stages of the investment process and take the final decision about the transaction. Another paper by McNally (1997) confirms the result, claiming that only 9 percent of CVCs of the analyzed data set were able to make investment decisions independently. Regarding the dimension of capital allocation, Siegel et al. (1988) was able to prove a rather high level of autonomy since almost half of the examined CVCs received the funding on a one-time basis, whereas other corporations disbursed periodically smaller amounts of capital to their CVC programs and only 19 percent reported an ad-hoc mechanism.

Besides the organizational structures and the authority of the parent organization through different instruments, the compensation model of CVC personnel is usually limited to a base salary and deviates from the performance-based salary structure IVCs offer their management teams (Dushnitsky, 2012).

The different organizational structures presented earlier in this chapter result from varying strategic objectives that corporations aim to achieve with corporate venture capital activities. Hill and Birkinshaw (2014) describe this phenomenon as a form of organizational ambidexterity, a synthesis of exploration and exploitation to leverage existing resources while simultaneously creating new combinations to address future market demands. Dushnitsky (2017) provides several examples of large corporations that monetized their current product offer through strategic investments of their own CVCs into ventures that collaborated afterward with the parent company. Another strategy employed by CVCs is to invest in ventures to build an ecosystem of products and services that benefits both the parent company and the broader market (Dushnitsky, 2017). In this case, the offerings of acquired ventures are not market-ready yet and need the resources and capacities of others in order to launch. In addition to that, parent

companies aim to explore new technologies to keep up with trends, achieve a financial surplus, and develop their business networks (Dushnitsky & Lenox, 2006; McNally, 1997; Siegel et al., 1988; Strebulaev & Wang, 2021). Overall, researchers agree that CVCs predominantly follow a hybrid combination of monetary and strategic objectives (Rossi et al., 2017).

2.4 Investment Decision Process

As the name already implies, venture investing implies risk by its nature. Therefore, venture capital funds have established thorough processes to evaluate startups before investing, which helps to understand the opportunities and challenges a venture might bring. Leading authors of the scientific management literature of venture financing agree that the selection process for new ventures can be categorized into several phases, including at least two steps: screening and evaluating the venture (Hall & Hofer, 1993).

As one of the first scholars who analyzed thoroughly the investment processes within the venture capital industry, Wells (1974) proposed a structure of six discrete phases consisting of 1. Identification of ventures, 2. Assessing the proposals, 3. Evaluation of the proposals, 4. Funding Decision, 5. Providing additional financial and non-financial support for portfolio ventures, and 6. Exiting the investment. Almost a decade later, Tyebjee & Bruno (1984) built on this process while merging phases four and five and adding a new stage for deal structuring. By revisiting Wells (1974) and Tyebjee & Bruno (1984), the authors Hall & Hofer restructured 1993 the selection process with a new model by proposing eight distinct phases, which still has accuracy according to scholars from recent publications. Since Hall & Hofer (1993) and Fried & Hisrich (1994) cover together most aspects of modern processes of venture selection by VCs and are among the top cited scholars on the topic, this chapter will describe the process following the structure of the two studies. In addition, this chapter includes insights of (Klonowski, 2012), who connected essential steps of documentation as well as mandatory approvals of decision-making units. Since the process stages of selecting potential investments are similar between most CVCs and IVCs, this chapter will provide a general overview that applies to both types of venture capital funds.

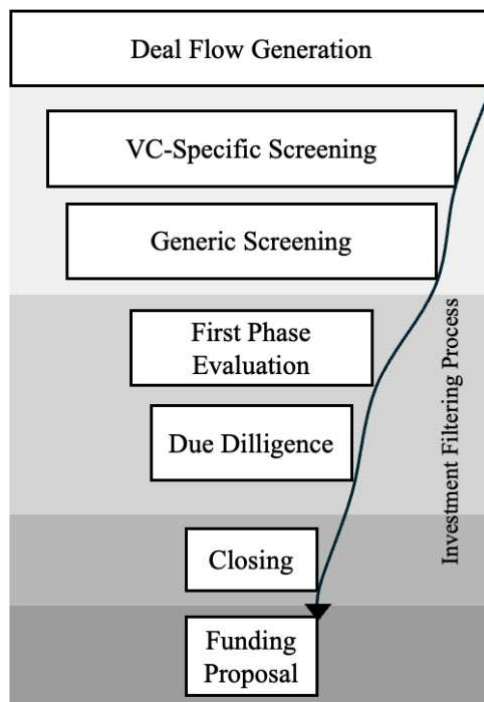


Figure 4: Venture Selection Process adapted by Hall & Hofer (1993) and Fried & Hsrich (1994)

The so-called deal flow generation or origination phase alludes to the very beginning of the process of selecting investments. It involves systematic methods to identify target ventures and respective startup owners and how to reach and convince them (Teten & Farmer, 2010). From a founder's perspective, contacting VCs via the right channel is essential. Scholars found that the source of origination for a potential venture moderates the likelihood of proceeding to the subsequent phases of the selection process (Fried & Hisrich, 1994). While most startups usually reach out via unsolicited funding requests (without previous introduction), they barely capture any attention from VCs this way (Fried & Hisrich, 1994). Due to this high number of unsatisfying proposals, venture capitalists developed proactive deal-sourcing strategies by establishing networks and industry events. Scholars found that this greater quantity of relevant startups by following a more active deal-sourcing approach also leads, on average, to higher returns (Teten & Farmer, 2010). This differentiation of warm and cold contacts was also studied by Tyebjee & Bruno (1984) who found that while just 26% of founders moved into subsequent screening phases following an unsolicited request, more than 65% of ventures with recommendations of other VCs or direct contact through the network were able to progress to the next stage of the process. Besides own efforts of origination, Groh & von Liechtenstein (2011) argue that a venture capital fund's reputation is deeply tied to its access to high-quality deals as well.

The following initial VC-specific screening phase amounts according to Hall & Hofer (1993) solely around six minutes on average. In this stage, VCs usually analyze whether the investment size, the industry of the startup, the geography of the investment and the stage of the venture matches their target criteria, so-called eligibility criteria (Fried & Hisrich, 1994). The aim of this phase is to quickly identify potential deal breakers in order to use the VCs' resources as efficiently as possible (Klonowski, 2012). In some cases, the appointed venture capitalist already screens over the main points of the business plan and get some broad information on the founder and the market (Fried & Hisrich, 1994).

The generic screening aims to analyze the concrete investment proposal based on the provided business plan, information about the market size, growth prospects, and the venture's founder (Fried & Hisrich, 1994). In this step, the venture capitalists' "knowledge base" plays a crucial role as the accumulated experiences of the investment firms help to identify weaknesses or dealbreakers very early in the process (Klonowski, 2012). Some scholars argue that the screening process at this stage might be less stringent applied if a highly reputable source refers the investment opportunity (Fried & Hisrich, 1994). Typically, the number of meetings with the venture candidate is minimal at this point to preserve the team's capacity (Drover & Ademi, 2020). By the end of a successful screening stage, meaning that the startup will be analyzed in more detail in the subsequent phases, the VC has usually already created a preliminary memorandum to qualify the deal and report the most critical points (Klonowski, 2012). Overall, the whole screening stage is solely based on the venture's documentation without incurring external costs for the VC (Klonowski, 2012).

Moving on to the first phase of the evaluation stage, the startup candidate undergoes general monitoring. At this point, VCs compare the information provided by the startup with external insights, e.g., feedback from actual or potential customers of the firm's products and services (Fried & Hisrich, 1994). Furthermore, the venture capitalist thoroughly investigates the startup's financials by interacting closely with the founder or the responsible financial officer, especially in order to understand the underlying assumptions for the forecasts (Klonowski, 2012). Besides the financials, the business plan is thoroughly analyzed in terms of the viability and available capacities of the firm. Additionally, the VCs gather in-depth information on the market, the competitive landscape, and the strategic or innovative edge of the venture's value proposition, but without any external evaluation at this point (Klonowski, 2012). As the third major component, the founders and executive managers of the venture are critically assessed during several meetings with regard to their experience, understanding of the business and the

industry, competitors and how to overcome potential challenges (Blume & Hsueh, 2024). Depending on the stage of the venture within the lifecycle, the focus of the evaluation phase is set differently, either on financial aspects for later-stage startups or the management team and the business idea for early-stage ventures (Fried & Hisrich, 1994). Some VCs already discuss at this stage potential opportunities and concerns with members of the investment committee to be able to address as many of these commercial and deal issues as possible until the next stage (Klonowski, 2012). The First Phase Evaluation is often closed with a signed term sheet, where both parties agree contractually on key terms. Moreover, this agreement serves additionally as a certain guarantee for the upcoming costly Due Diligence and the involvement of external advisors (Brown & Wiles, 2016).

The second phase of the evaluation phase, the Due Diligence, involves an in-depth assessment of the startup in multiple dimensions. Leading scholars underline the high importance of this phase to avoid the phenomena of adverse selection due to the lack of publicly available data (Chicktay & Barnard, 2018). As some studies also refer to this stage as the so-called “external due diligence”, the phase is often characterized by the extensive support of external advisors. The primary risks that venture capitalists must evaluate include financial risks, legal risks, technological risks, market risks and environmental risks (Proksch et al., 2018). In order to assess the financial situation of the venture, VCs often collaborate with accounting advisors to restate financial data in international accounting standards, uncover off-balance sheet liabilities and control for accurate accounting processes of the venture (Klonowski, 2012). The legal due diligence covers the assessment of agreements with external parties, control for a proper constitution and related-party transactions as well as proceedings of the startups (Klonowski, 2012). The technological risks are often associated with the market readiness of products and challenging milestones on the way to finalizing a working technology (Proksch et al., 2018). Since VCs often do not have the capacity to assess products of very specialized industries internally, they tend to invite dedicated experts for an external evaluation. Market risks are closely associated with the commercialization of the product (Wang & Wang, 2011). However, Kaplan and Strömberg (2004) revealed in their empirical study that factors like market size or customer adoption risks are only emphasized on a medium to low level in the analyzed investment documentation, also providing inferences of the perceived risk. Especially in recent years, environmental due diligence has played a more important role as limited partners have higher expectations regarding ESG⁶ standards and reporting (Antarciuc et al., 2018). This

⁶ ESG – Abbreviation for Environmental, Social and Governance

investigation usually includes topics of public importance like waste management and disposal or other environmental aspects (Klonowski, 2012). Overall, VCs reported spending for external advisory during the Due Diligence stage up to 2% of the invested capital, but might be reimbursed in case of a successful closing (Klonowski, 2012).

After successfully completing the Due Diligence stage, the funding proposal enters the Closing phase, where legal documents are negotiated and the deal structure is settled (Fried & Hisrich, 1994). Unexpected legal complications frequently develop during this stage of the procedure when the broad provisions of the agreement outlined in the term sheet are transformed into comprehensive legal documents (Klonowski, 2012). Despite the high effort in terms of time and resources both parties spend to reach this stage, only 20% of ventures are completing the Closing stage with a signed contract according to the study of Fried and Hisrich (1994). Assuming a successful agreement between the startup and the VC, the latter signs the so-called custodian letter to instruct the bank to settle the transaction in cash terms (Klonowski, 2012).

2.5 Investment Criteria - Early-Stage Ventures

As outlined already in the previous chapters, venture capitalist's success is measured in their ability to generate returns for their LPs and the achievement of additional strategic objectives in the case of CVCs. As the quality of the portfolio and its performance is a reflection of its risk assessment and the underlying criteria to evaluate investment opportunities, the topic of investment criteria has been an established research field since the 1980s (Eisele et al., 2011). Therefore, developing a wholesome understanding of the evolution of investment criteria for venture capital funding is essential. The following chapter will analyze the scientific exploration of this topic, focusing on major research milestones by Tyebjee and Bruno (1984), Macmillan et al. (1985), Hall and Hofer (1993), Zacharakis and Meyer (2000) and others. Additionally, the current state of venture capital investment criteria is presented through a merged structure, adapted by the studies of Granz et al. (2020) and Eisele et al. (2011). As the management literature provides an overabundance of possible criteria, this chapter will only present key factors confirmed by a number of studies to display the best possible approximation of variables. As the stage and the industry of the venture play a crucial role in the applicable investment criteria (Hall & Hofer, 1993), this review will mainly focus on factors applicable to early-stage ventures investing in software firms.

Tyebjee & Bruno (1984) published one of the first comprehensive papers on venture capital investment criteria. Conducting a factor analysis to condense many potential characteristics that could be used to evaluate a deal, they conceptualized the criteria into the five following dimensions: Market Attractiveness, Product Differentiation, Managerial Capabilities, Environmental Threat, and Cash Out Potential (Tyebjee & Bruno, 1984). A year later, the study of Macmillan et al. (1985) builds on that, while emphasizing the high importance of the entrepreneur’s experience as one of the most essential variables. It further adds a risk perspective from the VC’s point of view and how different funds aim to address potential risks during the evaluation (Macmillan et al., 1985). Almost a decade later, Hall and Hofer (1993) add to the discourse that investment criteria essentially depend on the venture’s lifecycle stage. In a dualistic manner, Wright and Robbie (1996) have studied the perceived importance of both financial and non-financial criteria among VCs in the UK. As more and more factors were developed over time, Zacharakis & Meyer (2000) emphasized the necessity to limit the amount of decision criteria to enable VCs to make investment decisions in a reasonable time. Throughout the decades of research on venture capital and investment criteria, scholars have not reached a consensus on which criteria are most important (Granz et al., 2020).

Addressing the heterogeneous and comparatively unstructured literature on venture capital investment criteria, Granz et al. (2020) and (Eisele et al., 2011) proposed very similar approaches to categorize investment criteria which can be merged into the following groups: (1) Management Criteria, (2) Characteristics of the Product, (3) Market Characteristics and (4) Financial Traction.

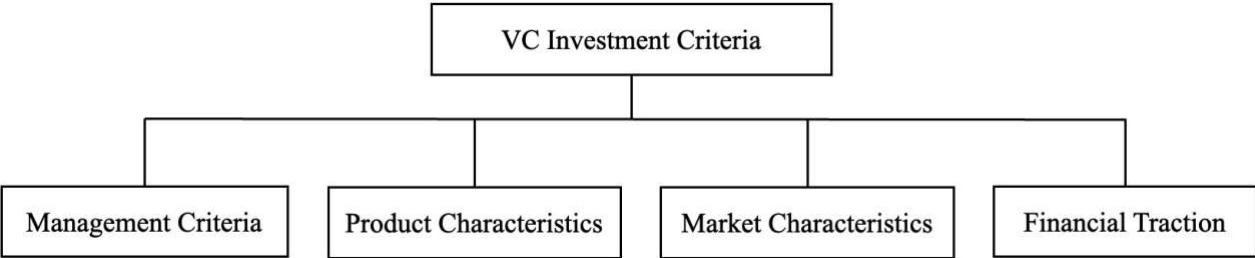


Figure 5: VC Investment Criteria

Studies indicate that, particularly for early-stage ventures, (1) Management Criteria are crucial for VCs to evaluate funding requests (Macmillan et al., 1985; Tyebjee & Bruno, 1984). Especially factors like experience, integrity and attitude of founders and managers towards their

teams are important signals for investors to assess the capability to execute the ideas effectively (Blume & Hsueh, 2024). The criterion of experience can be divided into human capital as well as previous founding exposure. The latter was analyzed by Zhang (2011) who found that serial entrepreneurs are expected to have more skills and relevant social connections compared to first-time founders. His quantitative study revealed that serial entrepreneurs that were previously venture-backed in an early stage or had experience with funding rounds in later stages have better access to VC funding for their current startup compared to novice founders (J. Zhang, 2011). Therefore, the paper underlined the importance of previous founding experience, especially the practice from funding rounds that helps to attract venture capital (J. Zhang, 2011). Another study by Landier (2005) analyzes this topic further, focusing on VC behavior on previous entrepreneurial experiences with failure. As a result, the scholar developed a theory of how this stigma can turn into a self-fulfilling prophecy. In an environment where failure is accepted, more capable individuals are inclined to launch risky startups. This leads to a group of failed entrepreneurs, including enough talented individuals to justify funding their future startup. On the other hand, in unforgiving environments, less capable individuals are inclined to engage in risky ventures, leading to a pool of failed entrepreneurs with low abilities that are not of any interest for VCs (Landier, 2005).

In addition to founding expertise, human capital⁷ is another important evaluation criterion for VCs that can be assigned to the topic of founder experience. A study by Colombo and Grilli (2005) analyzed the growth performance of young firms in high-tech industries that operate in services as well as manufacturing. As a result, they found that entrepreneurs with educational backgrounds or practical experience in management, economics as well as related scientific and technical fields tend to achieve higher growth rates for startups and secure more funding than founders without such qualifications (Colombo & Grilli, 2005). Moreover, the study proves synergistic effects of both educational and practical experience in managerial and technological areas, leading scholars to conclude that this complementary skillset is ideal for attracting investors (Colombo & Grilli, 2005). Adding to that, A. Zacharakis and Shepherd (2005) underlined that VCs expect management experience of entrepreneurs predominantly in competitive markets. Smart (1999) elaborated in a well-cited study on various methods to assess human-capital, such as reviews of documentation, samples of work as well as past-oriented interviews.

⁷ Human Capital – Skills and knowledge based on experiences and education (L.-F. Zhang & Sternberg, 2010).

Since entrepreneurial ventures demand significant persistence and dedication, founders' personality is an essential factor for VCs to analyze. Among others, Blume & Hsueh (2024) identified intrinsic motivation, drive and grit, as well as the capacity to convey the vision as crucial personality traits from a VCs perspective. As these criteria cannot be assessed with quantitative methods, investors tend to evaluate these factors with interviews of team members and stakeholders as well as from subjective judgement of meetings and presentations with the founders (Blume & Hsueh, 2024; Macmillan et al., 1985). Morawczyński (2020) found in addition that trustworthiness is essential to VCs, which is typically evaluated by external consultants or references. Overall, the personal fit of the founder with the dedicated venture manager is crucial as both work together once the venture is affiliated in the VCs' portfolio (Hall & Hofer, 1993). Baum & Silverman (2004) argue in a similar way that the personal fit also impacts the ability to coach the venture and, therefore, has influence to enable the full potential of the firm.

In addition to the outlined investment criteria regarding the management and founders of startups, VCs analyze the product or service and business structures as essential factors. Following the studies of Sandberg and Hofer (1987) venture capitalists assess the features of products and services on multiple levels. As crucial criteria, the authors point out product differentiation combined with a competitive advantage as compared to other solutions on the market. Additionally, the utility of the product for the customers was identified in several studies as an essential criterion for investors (Eisele et al., 2011; Macmillan et al., 1985). Moreover, Hellmann and Puri (2000) emphasized the importance of product innovation as they were able to prove that VCs prioritize innovator firms instead of imitators. Nadeau (2010) has further analyzed the effects of technical innovations considering Resource Based View theory, especially the effects of patents for fundraising. As a result, he found that patents for intellectual property have significant signaling effects on VCs regarding the quality of a venture and its product since it decreases information asymmetries, which is of essential importance for technology ventures. As investors aim for the firm's growth prospects, they underline the value of scalability of the product in several studies (Stein & Topche, 2021).

Besides company and product-specific characteristics that influence VCs' investment decisions, scholars, mainly from the economic domain, analyze market factors that investors assess. Brander and De Bettignies (2009) analyzed investment concentrations in certain sectors and how the industry experience of VCs influences investment behavior. With their model, they

were able to prove that VCs tend to invest if they recognize an unexploited opportunity within their domain of expertise, leading to cyclical funding dynamics. Moreover, the product or service should be characterized with high growth potential and an attractive market size (Eisele et al., 2011; Tyebjee & Bruno, 1984). Depending on the industry, some VCs consider potential entry barriers as additional criteria. Whereas US venture capitalists, especially, require the potential for market expansion of their assessed venture, DACH VCs do not regard this factor as a mandatory condition (Eisele et al., 2011). Regarding the competition within a market, Macmillan et al. (1985) argues that startup performance depends on the level of immediate competition as well as the acceptance of the product. However, Eisele et al. (2011) found that these factors are appreciated conditions, but not of essential importance for investors. Overall, if a sufficient market size and growth potential is given, other investment criteria regarding market factors are less critical for VCs in the DACH region (Eisele et al., 2011).

The fourth dimension of evaluation, the financial traction, is the often described as the most challenging part of the analysis. Since early-stage startups do not have a representative financial history that can be used as a solid basis with minor adjustments for a forecast as in corporate finance, the financial projections of business proposals are often not of the highest importance for the evaluation of a funding proposal according to VCs (Dixon, 1991). Therefore, investors assess this component instead in terms of plausibility to evaluate the entrepreneurs' ability to plan realistically ahead. Nevertheless, scholars found that the potential for a high return on investment (ROI) is an essential quantitative criterion for VCs (Eisele et al., 2011; Macmillan et al., 1985; Tyebjee & Bruno, 1984). However, investors are aware that the likelihood of a positive equity appreciation is relatively low, and the minority of the portfolio firms will achieve this objective. Moving forward and maturing in the startup lifecycle, the venture's quantitative database of financials and other key performance indicators (KPI) increases in accuracy over time and gets more important for investors (Hall & Hofer, 1993). Focusing on indicators of the profit and loss statement (P&L), VCs underlined in previous studies especially growth figures (Mason & Stark, 2004). Moreover, investors are keen to see a positive earnings outlook in the near future after making the initial investment (Granz et al., 2020). These figures are usually combined in the so-called "Rule of 40" which is of particular importance for investments in the software and high-tech industry. This rule of thumb usually assumes a trade-off between revenue growth and profitability, which is why investors developed this combined approach of evaluating a ratio of both figures (Hottenhuis, 2020). Besides evaluating P&L criteria, VCs assess the cash-flow situation as a second major category. Assuming the case that

a venture is not profitable yet, VCs set a special emphasize on the so-called burn rate as an expression for the amount of monthly cash decrease. Burn rates above average industry thresholds can further indicate poor capital efficiency that might be perceived as irresponsible cash management of the investment. In order to ensure that ventures do not run out of cash until the next funding round, VCs usually aim to provide capital that allows a cash runway⁸ of 12 to 18 months (Stein & Topche, 2021).

As early-stage ventures have limited access to debt funding, the capital structure is not a financial criterion that requires to be analyzed thoroughly. However, VCs evaluate the contractual obligations the venture might have towards other equity providers as this might create conflicts with their own investment and, therefore influence their investment decision (Mitchell et al., 1995).

In addition to direct financial criteria that VCs evaluate based on business plans or other provided documents, strategic considerations play a vital role for investors as well. Aiming to avoid long periods of locked-up investments, they expect ventures during Series A stage or later to have a product developed that is at least near market readiness to assure a certain level of liquidity (Granz et al., 2020). Moreover, numerous investors prefer a milestone-driven funding structure to disburse cash with an outcome-driven approach (Gompers & Lerner, 2001). However, this mechanism is more common in life sciences industries as in software (Stein & Topche, 2021). Another strategic factor VCs are looking for when assessing potential investments is a convincing equity story (Mason & Stark, 2004). Some investors already have potential partners for an acquisition in their network and aim to identify matching ventures. This might apply to the liquidity events of a share purchase or a strategic acquisition (M&A), where a new investor buys out a current one or a partner that acquires the whole company or essential parts of it (Walls, 2023). Furthermore, Yung (2012) explains the positive effect of having other reputable VCs invested as some kind of second opinion, which also attracts new investors. Another important component is the strategic fit to receive non-financial value-added services by VCs. These programs were established to enable firms of their own portfolio to benefit from the investor's network, support for operations or further funding (Ed-dafali et al., 2016).

Several other deal criteria might also influence the assessment of the venture initially, such as the clauses to prevent dilution or preferences in terms of stock types. As these criteria vary

⁸ Cash runway – the amount of time until the venture runs out of cash taking the burn rate into consideration.

severely between investors, they cannot be generalized and, therefore, do not represent the industry and common standards analyzed in this master thesis.

2.6 Investment Approaches of IVCs vs CVCs

This chapter will complement the literature review with the latest findings on differences in investment behavior between CVCs and IVCs. It will build on the previously presented different organizational structures and strategic approaches (chapter 2.3) and common VC investment criteria for early-stage ventures (chapter 2.5).

Only a few researchers have already contributed partly to this specific topic, comparing the different investment approaches of IVCs and CVCs with the conclusion of different implications for fundraising activities entrepreneurs. The review follows the same structure as chapter 2.5 with the categorization of Eisele et al. (2011) and Granz et al. (2020) analyzing differences in terms of the (1) Management Team, (2) Products Characteristics, (3) Market Characteristics and (4) Financial Traction. Similar to the previous chapter, the fourth part, (4) Financial Traction, includes differences between IVCs and CVCs in terms of strategic considerations.

Management Team

Regarding the evaluation of the management team, scholars have found that CVCs tend to prioritize technical expertise as well as industrial knowledge over other aspects in contrast to IVCs (Rossi et al., 2017; Shrader & Simon, 1997). This aligns with the strategic objective as some corporates potentially integrate some of their portfolio ventures later on and aim to leverage the innovative capacity of their parent organization (Dushnitsky & Lenox, 2006). In addition, Shrader and Simon (1997) found that CVCs have higher requirements for a personal and cultural fit of both the entrepreneurial team and the venture compared to IVCs. This fit would facilitate a smoother integration, especially in the case of an upcoming venture integration. However, the authors admit that this criterion is hard to compare.

Product Characteristics

Dushnitsky & Shaver (2009) argue that the observed CVCs of their sample revealed a significant tendency to invest primarily in ventures of the industry of their parent corporation that have protected their innovations with IP. One explanation provided by the authors is that

IP rights can serve as collateral in the event of insolvency, which could be valuable for the parent organization and support a risk-averse approach of the CVC. The other possible reasoning based on the fear of imitation is explained at the end of this chapter.

Market Characteristics

There are not many publications that observed different investment criteria between CVCs and IVCs based on market criteria. Some scholars found out that some CVCs have a very narrow market focus on investments they are targeting. In this case, the cyclical investment effects, presented in Chapter 2.5, would even increase according to Brander and De Bettignies (2009). However, this hardly translates into criteria that are taken into consideration by VCs valuation purposes but rather as eligibility criteria.

Financial Traction

Moreover, a number of scholars found that CVCs tend to have shorter investment horizons than IVCs (Dushnitsky & Lenox, 2006), impacting mainly the fourth dimension of investment criteria, the Financial Traction. Due to the fundamental organizational difference of having the parent corporation as the only LP, CVCs are highly influenced in their decision-making as they often do not have full authority over the investment decisions. As corporate managers usually have to deliver results in a shorter time than the average lifespan of an IVC fund of 10 years (Waite, 2016), CVCs reflect these circumstances in their investment behavior as they usually invest in more mature stages of the venture, timely closer to a potential exit (Dushnitsky & Lenox, 2006). Following this approach CVCs cannot benefit from the full growth potential of the startup, while having a lower risk profile as there are more components that can be analyzed, and the level of information asymmetries is lower. However, CVCs follow a dual approach of financial as well as strategic objectives in contrast to IVCs and might equalize the lower financial performance with strategic benefits for the parent corporation (Chemmanur et al., 2014). The results of Hellmann (2002) have confirmed the phenomenon additionally with the observation that IVCs have the tendency to pay lower prices as CVCs for the same investment, possibly due to a different valuation of strategic assets by CVCs within the venture. Other scholars explain the lower financial performance of CVCs with the lack of performance-based rewards (Chesbrough, 2000). Some authors further argue that financial criteria overall play a subordinate role in the selection of ventures for CVCs as they focus on strategic aspects (Maula et al., 2005).

Value-add Services

Maula et al. (2005) conducted multiple regression analyses to identify significant differences in terms of non-financial value-add services between CVCs and IVCs. As a result, the authors concluded that IVCs can provide superior support when it comes to the arrangement of new funding rounds, support of sourcing and hiring important personnel as well as strategic and organizational consulting. On the other hand, CVCs have a higher credibility in supporting their ventures with concrete technical issues and in reaching new domestic or international customers, providing support through the corporate parent and its network (Maula et al., 2005). These different approaches of supporting funded portfolio firms influence the investment decision process of VCs, as a strategic fit and the ability of a firm to benefit from the services enhances the chances of success and growth potential. Several scholars have evaluated the value-add services of CVCs as more valuable for startups since the young firms can leverage their operations with an established industry leader as partner immediately. However, Dushnitsky and Shaver (2009) have discovered a significant avoidance of high technological early-stage firms entering funding contracts with CVCs with the parent organization in the same industry, based on their fear of imitation. This so-called *Paradox of Venture Capital* solely applies to ventures that have not filed for IP protection. Acknowledging this behavior, CVC managers shifted their focus to more mature startup stages and ventures that have protected their innovations with IP (Chemmanur et al., 2014; Dauderstädt, 2013; Dushnitsky & Shaver, 2009). Overall, researchers found that ventures have the most significant benefit from value-added services if both IVCs and CVCs back them (Dushnitsky & Shaver, 2009; Maula & Murray, 2001).

Exit Preferences

In addition to that, Useche & Pommet (2021) identified exit preferences as another difference between IVCs and CVCs that can be reflected in their investment criteria. IVCs and those CVCs that have a financial institution as their parent organization proved to prepare their ventures better for IPOs. In contrast, ventures that are backed by CVCs with a non-financial corporate parent have a higher likelihood of getting de-listed soon after going public (Useche & Pommet, 2021). Furthermore, the authors found that ventures funded by CVCs with non-financial parent organizations benefit from the technical expertise and a network to larger organizations within the industry. This leads to enhanced opportunities for exiting the firm by a trade sale or a merger (Useche & Pommet, 2021). These differences further impact the initial process by VCs of selecting ventures since investors emphasize the importance of a comprehensive equity story,

sometimes already with a potential exit scenario or even a concrete buyer in mind. However, Maula and Murray (2001) discovered that ventures that are both backed by IVCs and CVCs (regardless of the parent organization's industry) achieve, on average, the highest valuations for IPO events.

3 Methodology

3.1 Research Design

This master thesis is based on a qualitative research design, with semi-structured interviews as the data collection method. Other researchers on this topic applied other methods like a literature review (Granz et al., 2020), quantitative data-driven approaches (Tyebjee & Bruno, 1984) with the implementation of regression models or machine learning models (Bai & Zhao, 2021) specifically focusing on the impact of a single investment criterion. In contrast, this master thesis aims to provide a general overview to cover the key criteria for investment decision-making with a qualitative approach evaluating the latest insights by industry experts. Especially since the topic of investment criteria can be sensitive due to internal company confidentiality, this method allows for insights into important or preferred categories. By focusing explanations on a specific field and frequently repeating certain criteria, a venture analyst can reveal valuable information about the investment preferences. Semi-structured interviews allow by design the interviewee to have the necessary flexibility to dive deeper into topics and criteria that are of high relevance by personal evaluation (Rutledge & Hogg, 2020). This enables to extract industry insights that possibly remained obscured through a standardized data sampling approach, missing the option of direct interaction (Rowley, 2012).

3.2 Research Objective

This master thesis aims to identify the differences in venture investment selection between different types of venture capital funds, specifically Independent Venture Capital Funds and Corporate Venture Capital Funds. Based on a comprehensive literature review, these two categories of investment funds were analyzed first regarding their different strategic and organizational structures. Since the involved stakeholders have an essential influence on the investment practice of a fund, the analysis of these components is crucial in order to explain reasons for possible differences between CVCs and IVCs. In the second step, the current state of the literature on investment criteria, as well as researched differences in investment behavior between CVCs and IVCs were presented. On this basis, hypotheses were developed and tested for agreement and relevance through qualitative expert interviews. As a result, this Master's

This thesis will provide two target investment profiles to serve startup founders as guidance during fundraising processes for identifying suitable equity investors.

3.3 Methodology of the Sample

This study requires the participation of experienced industry professionals from the venture capital field within the DACH area, who voluntarily contribute with a semi-structured interview to this master thesis. Venture capital experts are a group of professionals who screen thousands of funding proposals a year (A. L. Zacharakis & Meyer, 2000). As they interact daily with founders and are deeply involved in the venture selection process, they are also hard to reach for research purposes due to time constraints. Following the approach of Johnson (2014), first participants were selected from the direct environment of the researcher. Building on that, some candidates gave references to further potential interviewees who were contacted subsequently via Email or LinkedIn. Before the outreach, candidates were filtered by the following criteria:

1. At least one year of continuous industry experience, including at least six months of specific experience with the current VC fund.
2. Focus on investments in early-stage funding rounds (Series A or Series B) and software solutions within the DACH region.
3. Distinct organizational profile as either a Corporate Venture Capital fund or an Independent Venture Capital fund.

Before the interviews, the outlined selection criteria were reviewed with additional information from the data platforms PitchBook and Crunchbase to identify the general scope of the fund, recent activity and information on the organizational background. In addition to that, complementary information on the interview candidates were sourced from the platform LinkedIn as well as publicly available information from the VC funds websites about the team members.

Industry experts with experience in screening funding proposals and evaluating ventures can offer unique insights on the topic and have specialized knowledge about the relevant criteria of their funds. Their understanding of the processes of both CVCs and IVCs is fundamental for a realistic differentiation of each investment approach. In accordance with the findings of Soest

(2023) this procedure of interviews with dedicated experts further reduces potential biases and information asymmetries as the industry professionals can offer the information firsthand. Once the researcher recognized that candidates from each fund category did not provide substantial new insights beyond the fourth interview, the value of conducting additional interviews was no longer justified in accordance with the theory of Lowe et al. (2018).

The following table presents an overview of the interview candidates of the study:

Interviewee	Role	Description
CVC 1	Venture Analyst	More than 3 years of consecutive experience in VC, business development and consulting
CVC 2	Analyst	2 years of consulting and finance experience, thereof 0.5 years with the current CVC
CVC 3	VC Investment Associate	VC expert with 5 years in the industry and 2 years with the current CVC
CVC 4	Investment Associate	VC expert with more than 5 years of investment experience, thereof 3 years with the current CVC
IVC 1	Venture Advisor	2 years of experience in evaluating and advising ventures
IVC 2	Growth VC Investor	More than 2 years of consecutive experience in venture investing, thereof 1.5 years with the current IVC
IVC 3	Senior VC Analyst	1.5 years of consecutive experience in venture investing with the current IVC
IVC 4	Junior Finance Manager	2 years of experience as a Junior Finance Analyst and Junior Finance Manager at the current IVC
IVC 5	Partner	VC expert with more than 5 years industry experience in leading VCs in the DACH region.

Table 1: Interview Candidates

3.4 Interview Structure

The guidelines and questions for the conversation were structured in advance of the first interview (as attached in Appendix 1). The interviews were mainly conducted via Microsoft Teams between the Beginning of July and the End of August 2024. Candidates were informed about the scope and the general topic of the study as well as the data privacy standards of this master thesis. They were given the option to participate with their name and firm name in the study or get anonymized.

At the beginning of the interview, candidates were asked to introduce themselves, including their current position, the responsibility of this function, and their educational background. This is important in order to place the information in the right context and ensure that industry insights are received from experts with a minimum level of professional experience. Especially in the field of VC, the educational background is of importance because, unlike other areas of finance, this industry is known for employing people from a wide range of study programs, not just finance or management. In addition, interviewees were asked how long they have been with their current VC fund to ensure that they have sufficient experience with the firm's investment practices. Further, candidates were asked about potential prior employment in the venture capital industry as this could reveal insights of their perceived differences of investment approaches between different funds. The next category of questions aimed to identify insights about the VC fund structure. As most industry professionals usually know about the differences of Corporate Venture Capital Funds and Independent Venture Capital Funds, they were asked directly to categorize the firm they are working for accordingly. In order to ensure a common understanding of these terms, interviewees were asked more specifically about the organizational structure, the level of autonomy, and the decision-making power of the General Partner (i.e., fund management team). If the response confirms that the VC is categorized as a CVC, the candidate was prompted to elaborate on the structural connection of the parent firm. Further, the interviewees were asked about the general strategic objectives of their fund, as this significantly influences the firm's investment criteria.

Having information on the context of the interviewee's background and the investment firm's investment criteria, the next set of questions aimed to generate insights into the firm's investment criteria. First, the candidate was asked about the so-called "Investment Thesis" of the fund, meaning the investment strategy, deal preferences as well as the industrial focus of the fund (Iris Venture Capital, 2024). The following questions ensure that funds are compared only with the same vertical focus and approach to initially invest at the same lifecycle stage of the venture, avoiding observed differences related to a different investment scope.

The next set of questions focused on the specific investment metrics. These questions were structured open-ended on purpose to trigger intuitive answers, with the most elaborative explanations on the most important criteria, following the methodological approach of Bell et al. (2023). In addition, the interviewee was asked to rank the applied investment criteria of the fund according to the perceived importance for the decision-making of the investment committee. Moreover, the candidates were asked of their perception in terms of risk averseness, also compared to other VCs. As the professionals discuss with other VCs funding rounds the

terms of a deal, they quickly develop a feeling if their management or investment decision committee asks for more risk-limiting clauses, e.g., IP as collateral. Furthermore, the interviewees were asked about their fund's offer of non-financial support / value-added services post-investment, also in comparison to what they observed of their co-investors. In addition to that, candidates should elaborate on strategic reasons for this support as this provides a clearer picture of the overall investment approach of the VC. To draw the bow to investment criteria as the core topic of the master thesis, the experts were asked how a strategic fit and the ability to support a venture influence their evaluation during the due diligence.

The last set of questions is structured to cover the topic of exit considerations. First, experts were asked about the average and maximum investment horizon, meaning the time frame from the initial investment until the exit. This factor is considered to influence the applied criteria as well since long-term investments require different preconditions than short-term investments (Khanin & Turel, 2012). In addition to the investment horizon, the interviewees were asked about potential preferences regarding the exit scenario. As outlined in the literature review, some VCs already consider a potential exit scenario or the strategic fit to potential buyers of their network in the due diligence as an investment criterion.

The interview framework was developed to provide a database from current industry professionals to answer the following research questions as well as the *underlying supportive questions*:

Q1: Which investment criteria are of the highest importance for IVCs and CVCs?

- *How do investment criteria and their perceived importance differ between IVCs and CVCs?*
- *How do these differences impact the respective investment decisions?*

Q2: What instruments are CVCs and IVCs using in order to provide non-financial value-added services and how do these services impact their respective investment criteria?

- *How do the non-financial value-added services offered by CVCs compare to those offered by IVCs?*
- *Are startups that are compatible for the respective services by the VC perceived with a higher attractiveness for an investment?*

Q3: How do exit strategy preferences differ between IVCs and CVCs?

- *What are the exit strategy differences for IVCs and CVCs?*
- *Why is there a difference in these preferences?*
- *Does the difference impact the respective investment criteria of IVCs and CVCs?*

3.5 Data Analysis

Once the interviews were completed, the first transcribed drafts were available to download from MS Teams. These documents were carefully reviewed manually and corrected for possible software translation mistakes. The interview protocols were further anonymized to protect the participants' data.

As the management literature already analyzed several components of the differences of investment selection criteria of IVCs and CVCs (chapter 2.6), a deductive approach was justified following the theory of Baur & Blasius (2022). As proposed by (Mayring, 2010), the coding to analyze the results was created before conducting the interviews based on the current state of the literature. The codes provided the necessary structure to evaluate the findings from the interviews. The software MAXQDA was used for the analysis as the tool allows the automatic categorization of the coded parts of the text. First, the codes as outlined in Appendix A were noted in the Software to generate corresponding tags. These tags were used to mark part of the interview protocols to assign them to codes. Afterwards, the software provided an overview of all highlighted parts for each tag. These categorized highlighted parts are compared in the following part of the master thesis. Some direct citations from the interviews were selected in order to present the analysis visually. The complete interview protocols are attached to this document in Appendix B: *Expert Interviews*.

3.6 Ethical Considerations

This master thesis is developed under strict adherence to ethical principles for scientific research. The selection of interview candidates was conducted under equal conditions, including a mix of nationalities, genders, and ages. Before the interviews, every candidate was informed thoroughly about the overall study topic, the context of the research and their impact with the participation. Every interviewee offered the support to the project voluntarily by taking the time to explain their points of view in the semi-structured interviews. Due to constraints

concerning the various locations of the candidates within the DACH area, the conversations were held online using the application MS Teams. All participants approved the use of voice recording and automated transcription features of MS Teams, also considering the data privacy guidelines by Microsoft and the online storage of the interviews. After the conversations, every participant was granted access to the transcripts to ensure that what was said corresponded to the candidates' intentions. All participants had the choice to cancel or leave the conversations without any consequences or to neglect the use of the transcript for this master thesis.

4 Presentation of Interview Results

The presentation of empirical results is displayed in a similar structure as proposed in the literature review in Chapter 2.5 and 2.6 for an easier comparison of the findings. Therefore, the results of the interviews are structured in the evaluation categories of Management Team, Product Characteristics, Market Characteristics, Financial Criteria, Strategic Fit for Value-Add Services and Exit Scenarios. The beginning of each chapter entails a table, providing an indication of the overall relevance of the evaluation category in comparison to other factors. The categories are structured into three levels of perceived importance (high, medium and low) from the VC's perspective. Further, the bottom line of each table includes a score that represents the average rating across the three categories: high (3), medium (2), and low (1). This average is calculated by adding up all the category values and dividing them by the number of observations. A higher score indicates a greater perceived importance of the investment criterion in the investor's evaluation process, vice versa.

Management Team Criteria

<i>Management Team</i>									
	<i>CVC 1</i>	<i>CVC 2</i>	<i>CVC 3</i>	<i>CVC 4</i>	<i>IVC 1</i>	<i>IVC 2</i>	<i>IVC 3</i>	<i>IVC 4</i>	<i>IVC 5</i>
<i>High</i>	X	X		X	X	X	X	X	X
<i>Medium</i>			X						
<i>Low</i>									
<i>CVC</i>	2,75								
<i>IVC</i>	3,00								

All interviewed VCs, regardless of IVC or CVC, underlined the significant importance of evaluating the venture's management team for the venture selection process. However, the two different types of funds, the corporate venture capital funds and the independent venture capital funds revealed different focus areas within the overall category of management teams.

CVCs reported that they strongly emphasize the industry and technological expertise of the management teams as an essential component to evaluate. Some funds reported that they have members of business units and technological experts from the parent company who participate

if needed with founder meetings and discussions with the IC as they have a deep domain knowledge and can evaluate technological details. Other interviewees further revealed that CVCs value if management teams have previous experience in large corporations. The investors explained that they are aware of cultural differences between the startup and their parent corporation. However, relationships with portfolio ventures are often characterized by a close technological collaboration with internal business units or by a customer-supply relationship. If the founders are already familiar with workflows and processes of large corporations, ideally in the industry of the parent organization and the startup, both the investor and the portfolio venture have lower communication barriers and work more efficiently together.

“Of course, we try to evaluate a good mix of soft skills, previous management experience, and industry experience. Especially with founders who have worked in large corporations for a while, ideally in the energy sector, cooperation is easier - they understand if it takes a little longer with decisions and later find it easier to collaborate.” - CVC 1

Adding to that another CVC reported that they also highly appreciate the flexibility of startups in being coached and the openness for technical collaboration. As some startups, especially in the early stage, fear the imitation of their business by large corporates of the same industry, only some are open to discuss on a deep technical level their invention. Moreover, another investor emphasized that her fund values teams that show prudence in decision-making and have clear strategies of managing potential risks as the fund has a limited tolerance for failure.

On the other hand, IVCs reported that they focus heavily on leadership abilities of founders. In addition, IVC investors underline the importance of an entrepreneurial track record of the management team. The ability to execute a vision that was potentially proven in a prior startup is perceived as a solid signal that the team has the competence to meet the rapid growth expectations and adapt to a fast-paced environment. It further shows the willingness to take bold steps and innovate aggressively. An experienced manager from a leading DACH VC adds that a founder's mental capacity, comfortable to deal with highest pressure, is crucial to be entrusted with the potential to develop ideas to 10x valuations. Furthermore, most of the interviewed IVC investors emphasized the importance of the personal fit of founders to the investment teams or respective business development units of the fund as they usually work together for years.

„The team is very important to us because we maintain a close relationship with the companies over several year.” - IVC 2

One IVCs even explained the mandatory condition that the founding team is still with the company, as it is otherwise perceived as an early warning indicator that founders do not believe enough in the business model or have internal problems.

“Founder replacement typically happens at a later stage, and not being founder-led at this stage can be a red flag.” - IVC 3

Product Characteristics

<i>Product Characteristics</i>									
	<i>CVC 1</i>	<i>CVC 2</i>	<i>CVC 3</i>	<i>CVC 4</i>	<i>IVC 1</i>	<i>IVC 2</i>	<i>IVC 3</i>	<i>IVC 4</i>	<i>IVC 5</i>
<i>High</i>		X	X	X			X		
<i>Medium</i>	X				X	X		X	X
<i>Low</i>									
<i>CVC</i>	2,75								
<i>IVC</i>	2,2								

Both types of VC investors expressed the importance of an innovative product with a proven market fit when evaluating product characteristics. In addition to that, most interviewees highlighted the criterion of competitive advantage compared to other products on the market. Specifically, regarding software investments, both VC investor types highlighted product criteria that create locked-in effects for customers, to increase loyalty without higher marketing expenses.

Corporate Venture Capitalists even put a higher emphasis on product characteristics as most of them described these factors as crucial for their investment decision. Furthermore, an interview candidate from a CVC explained that the fund conducts a different assessment on the product assessment as experienced in earlier functions with IVCs. As some CVCs combine the financial investment approach with strategic objectives, the target product needs to fulfill a strategic fit

with the parent corporation, e.g. by complementing the current product offering, enable the parent organization to enter a new market or leverage operations within existing channels. Adding on that, another interview candidate further draw attention to the compatibility of the product or service with the existing environment of the corporation, as this factor was usually highly appreciated by the IC of his fund.

*“What might be special about our approach is that we also look at the potential of the product in relation to the group, how compatible it is, and whether it could complement the portfolio”
- CVC 1*

Another aspect that a CVC candidate highlighted is the alignment with the regulatory requirements of the parent organization's main domestic market. He presumes an easier integration of the product or service in the portfolio of the parent organization as a possible reason and further adds that this is of special importance for startups in the field of insurance and finance. Moreover, another CVC interviewee pointed out that his fund tends to invest in ventures that protect their intellectual property already with patents, as this also enables a closer relationship with the startup under a legal basis with more insights into technical details. In addition, this also serves as a more risk-averse approach since arrangements of exclusive access in case of bankruptcy can be negotiated. Furthermore, some CVC interviewees stressed the importance of a long-term vision of the product or service that is evaluated of higher importance than quick scaling.

The interview candidates from IVC funds highlighted the disruptive potential of the product as an essential criterion. Some further stressed characteristics like scalability and the respective opportunity to capture significant market share in a short amount of time. One Interviewee explained in addition that this requires also sometimes to invest in unproven technologies with higher risks.

“To ensure high growth potential, we sometimes invest in completely new solutions that still have to prove themselves. This is then high-risk, high-reward.” – IVC 1

Other IVC candidates underlined the importance of product features that have first-mover potential, further support the investment thesis to identify ventures with high-reward opportunities.

Market Characteristics

<i>Market Characteristics</i>									
	<i>CVC 1</i>	<i>CVC 2</i>	<i>CVC 3</i>	<i>CVC 4</i>	<i>IVC 1</i>	<i>IVC 2</i>	<i>IVC 3</i>	<i>IVC 4</i>	<i>IVC 5</i>
<i>High</i>		X			X	X		X	X
<i>Medium</i>	X		X	X			X		
<i>Low</i>									
<i>CVC</i>	2,25								
<i>IVC</i>	2,8								

The overall result of the interviews underline that while both types of investors have essential requirements that need to be fulfilled for the market perspective of the venture, investment criteria of this category have a higher importance for IVCs as compared to CVCs. This is also expressed by a significantly smaller score in the table. However, candidates of both investor types emphasize a sufficient market size for growth and long-term development.

The market size is always evaluated in relation to strategic objectives according to CVC interview participants. In addition, CVC candidates underlined a focus on markets where the parent company can benefit from synergies. This strategic relevance of the market often implies that the parent organization or group of the CVC has already present operations in the respective segment. Other interviewees further add that the target market should bring the potential of expansion for the parent company or provide insights from new market segments as well as consumer behavior understanding.

As IVCs are mainly focused on growth, the size of the addressable market is a key element for the respective analysis. In addition to that, the flexibility and market dynamism play a key role as typically less mature markets have higher upside potentials according to an investment professional from an IVC. The aforementioned first-mover advantage also applies to the market environment. One experienced candidate described these relatively untapped markets as “Greenfield Opportunities”, that underline the willingness of IVCs to target also unfamiliar

environments. This potential even unfolds as a stronger criterion, if the market has significant entry barriers for competitors.

“We’ve also invested in new markets in the case of greenfield opportunities, where market entry barriers play a major role in allowing the company to grow to a size where it can compete.” – IVC 4

In addition to that, the market should be characterized by clear drivers for demand that allow for quick product adoption. One interviewee also explained that the approach of his fund is more agnostic about the industry as long as the overall eligibility criteria are met and the market offers the opportunity for outsized financial returns.

Financial Criteria

<i>Financial Characteristics</i>									
	<i>CVC 1</i>	<i>CVC 2</i>	<i>CVC 3</i>	<i>CVC 4</i>	<i>IVC 1</i>	<i>IVC 2</i>	<i>IVC 3</i>	<i>IVC 4</i>	<i>IVC 5</i>
<i>High</i>			X	X		X	X	X	X
<i>Medium</i>	X	X			X				
<i>Low</i>									
<i>CVC</i>	2,5								
<i>IVC</i>	2,8								

Interview candidates from both groups reported that industry-specific key performance indicators are essential for the evaluation. Specifically for software solutions, some candidates explained to evaluate growth proxies and profitability figures into perspective with the “Rule of 40”. Most interview candidates further explained the importance of seeing high potential for the return on investment. Further, the analysis of the cash flow situation is an additional overlap of both investor types, ensuring investments in efficient and “financially healthy” firms.

The company should also have a cash runway of at least 12 months with our investment and manage the money efficiently. – IVC 1

However, CVCs and IVCs reported different evaluation approaches and several deviating metrics to achieve their respective objectives. One candidate from a CVC fund reported that they consider the complementary financial benefits instead of focusing solely on the venture's independent financial success. He further elaborates that even in cases where the venture is not profitable yet, the whole group takes potential cost savings through the venture's technology into consideration.

“It can happen that a company is not yet profitable, but it makes sense to invest due to strategic advantages for the group, for example, through cost reductions achieved by increased efficiencies.” – CVC 1

Another interviewee highlighted that her CVC is not as strict in terms of financial benchmarks as she was used to it in previous jobs in IVCs.

On the other hand, candidates of IVCs reported that they are very sensitive to valuations as they aim to reflect as precisely as possible the potential of current and projected revenues. Overpaying can significantly impact the return on investment, which diminishes bargaining power when IVCs seek to raise additional funds.

Suppose we overlook anything or agree to unfair valuations. In that case, we endanger the overall fund performance with the result of unsatisfied LPs and have a more challenging time to raise new funds. – IVC 3

Adding on that, another IVC explains the necessity to conduct a detailed financial due diligence as their IC has a high focus on the financial situation of the venture. Moreover, a candidate underlines the evaluation of the capitalization table, a document entailing all current investors with their share in the company that is analyzed for current contractual obligations. Some investors in the capitalization table also serve as anchor investors, being a good indicator that a highly reputable fund has decided to invest. In addition, one CVC revealed to evaluate a high ownership stake of the founder as a positive indicator.

“Another important point is the composition of the CAP table; we prefer startups where founders retain a significant ownership stake.” - CVC 2

Furthermore, one interviewee revealed the importance of financial independence of the venture, which is why his fund participates barely in transactions with CVCs as co-investors as the objectives of both types deviate. Overall, all IVCs, despite one candidate, underlined the high importance of financial criteria compared to other evaluation categories.

Strategic fit for value-add services

<i>Strategic fit for value-add services</i>									
	<i>CVC 1</i>	<i>CVC 2</i>	<i>CVC 3</i>	<i>CVC 4</i>	<i>IVC 1</i>	<i>IVC 2</i>	<i>IVC 3</i>	<i>IVC 4</i>	<i>IVC 5</i>
<i>High</i>	X	X		X			X		
<i>Medium</i>			X					X	
<i>Low</i>					X	X			X
<i>CVC</i>	2,75								
<i>IVC</i>	1,6								

All interviews highlighted that venture capitalists, regardless of the type, offer the startups of their portfolio value-added services. The results of the two groups reveal a significant difference regarding the perceived importance of the strategic fit of the venture to be able to receive or benefit from the support by the VC, as presented in the table above.

CVC candidates reported in interviews that their funds support ventures by providing technical support through dedicated business units. In addition to that, other interviewees underlined the approach of matching the product or service of the venture with part of the existing offering of the parent organization, entering supply or customer relationships. As the associate explains, this resource-intensive support can substantially influence the performance of both the venture but also of operations of the corporate parent and further decreases the risk of investment. One CVC even stated that the fund mandates a partnership with the parent organization in the investment conditions.

Interviewees from IVC funds explained to support their ventures mainly through financial, strategic or operational advisory. However, one candidate revealed that his fund usually applies a broad approach as they do not have the capacity to deeply interact with the venture. Another

interviewee highlighted that even though his IVC has an operational approach to support startups with dedicated teams, the strategic fit does not translate into a preference of the investment process.

“Not necessarily. We invest based on the potential of the startup and not on whether our services are needed. But it certainly helps if we can provide support.” - IVC 1

Exit Scenario

<i>Exit Scenario</i>									
	<i>CVC 1</i>	<i>CVC 2</i>	<i>CVC 3</i>	<i>CVC 4</i>	<i>IVC 1</i>	<i>IVC 2</i>	<i>IVC 3</i>	<i>IVC 4</i>	<i>IVC 5</i>
<i>High</i>						X			
<i>Medium</i>	X			X				X	X
<i>Low</i>		X	X		X		X		
<i>CVC</i>	1,5								
<i>IVC</i>	1,8								

The candidates from both types of VC groups explained that they consider and evaluate possible exit strategies already before their initial funding. However, most interviewees report that this criterion is not as important as other categories like the management team, the product or financials.

Two CVC candidates explained that the IC of their fund expects an evaluation of the startup’s potential for future integration into the parent organization’s group. The other CVC interviewees pointed out that the type of the exit scenario is not an important part of the evaluation and, therefore has minor influence on the initial investment decision.

One IVC candidate explained that a concrete potential for a future trade sale with a partner in their network was a convincing argument for his IC, which usually considers the exit strategy and respective opportunities of the business model in the initial investment decision.

“We already had the case that a partner of our network had a great potential for a future acquisition. Situations like these are usually strong cases for our IC, increasing the likelihood for the positive vote to invest.” - IVC 2

One other IVC candidate examined the support of his fund of IPOs, before the current situation on the markets, as this strategy guaranteed in the last years the highest returns, compared to other exit scenarios. He further explained that his IVC has expertise in actively advising ventures for final transactions, which is why the fund takes the initial exit strategy into consideration for the initial funding decision.

Other characteristics

In addition to the investment criteria as mentioned earlier, one interview candidate from an IVC emphasized the evaluation of ESG criteria of the startups as a factor with increasing importance as LPs expect increasing reporting standards and some solely invest if certain ESG parameters are fulfilled.

5 Discussion

This master thesis aims to identify differences of the investment behavior between Independent Venture Capital Funds and Corporate Venture Capital Funds as a potential result of their different organizational structures. Respective preferences of certain investment criteria that deviate between the two types of venture investors can also help startup founders to address most effectively the right investment firms. The results are intended to provide additional insights for venture capitalists and entrepreneurs to better understand the venture funding environment in the DACH region and to improve mutual understanding among investors.

Therefore, this master thesis is structured along the following underlying research questions:

Q1: Which investment criteria are of the highest importance for IVCs and CVCs?

- *How do investment criteria and their perceived importance differ between IVCs and CVCs?*
- *How do these differences impact the respective investment decisions?*
- *What are the strategic reasons for the potential differences in terms of investment criteria?*

Q2: What instruments are CVCs and IVCs using in order to provide non-financial value-added services and how do these services impact their respective investment criteria?

- *How do the non-financial value-added services offered by CVCs compare to those offered by IVCs?*
- *Are startups that are compatible for the respective services by the VC perceived with a higher attractiveness for an investment?*

Q3: How do exit strategy preferences differ between IVCs and CVCs?

- *What are the exit strategy differences for IVCs and CVCs?*
- *Why is there a difference in these preferences?*
- *Does the difference impact the respective investment criteria of IVCs and CVCs?*

5.1 Critical Discussion of Empirical Findings

The following critical discussion of the results of the study is structured similarly to the previous results chapter as well as the chapters 2.5 and 2.6 of the literature review to present the content in a form. This discussion combines the information from the interviews with the latest research

findings from literature, considering underlying theories from chapter 2.2 to draw conclusions and argue for underlying reasons.

Management Criteria

In accordance with the studies of Macmillan et al., (1985) and Tyebjee & Bruno (1984), management criteria are highlighted by all interview candidates as one of the most important criteria for evaluating ventures within the early stage in the DACH region. The results from the interviews reveal that IVCs and CVCs have different preferences and focus areas within the overall evaluation category of management teams.

Independent Venture Capital Funds underlined that they have a high emphasize on the leadership abilities of the entrepreneurial team as well as their ability to execute. This result is in line with the findings of (Blume & Hsueh, 2024). Further, IVC candidates highlighted the entrepreneurial track record of founders as a positive indication for the current venture as they have already experienced several challenges that typically occur during the founding and development process. This result is supported by the study of Zhang (2011), who associated advanced skills with serial founders and predicted a higher likelihood of securing funding from this group of entrepreneurs. Since the interviewees did not specify if this evaluation only applies to previous successful founding experiences, the results cannot be compared to the study of Landier (2005), who analyzed the acceptance and evaluations on entrepreneurs that failed earlier on. Moreover, one interviewee highlighted the importance of founding experience in competitive environments, which is of special importance for IVCs as their growth expectations often go along with a certain level of competition. This result is backed by literature of A. Zacharakis & Shepherd (2005).

“The previous track record is also an indicator of whether the founder is truly capable of withstanding pressure, especially in highly competitive fields.” – IVC 1

CVC candidates underlined a high focus on the technical background of the management team, as some of them aim for a collaboration with international business units of their parent organization. This tendency is in accordance with the previous findings of (Rossi et al., 2017) who identified the difference that CVCs have higher requirements for the level of industrial knowledge of the entrepreneurial team as compared to IVCs. Previous authors also draw the

connection to deviating objectives between CVCs and IVCs as a potential result. The findings of Shrader and Simon (1997) that CVCs tend to have a higher focus on personal and cultural fit⁹, need to be differentiated from the results of the interviews. While some CVC candidates highlighted indeed the importance of an individual personal fit and appreciated previous corporate experience for a better understanding of processes in large organizations, IVCs emphasized this criterion as well, but rather in terms of the coachability of the venture.

Regarding the initial research question *Q1*, the evaluation category of the management team is one of the most important factors for venture capitalists. Both groups of investors have different focus areas within the category that can be explained by different strategies of risk-mitigation with the framework of the Principal-Agent Theory. While IVCs focus solely on the financial performance of the venture, they tend to prefer founders with a track record and entrepreneurial experience to solve arising challenges independently. CVCs apply a higher focus on industrial and technological knowledge as well as corporate experience and culture to ensure the selection of only agents (i.e., startups) that align with the objectives of the parent organization. This approach helps to reduce the likelihood of adverse selection, to choose agents that diverge from the principal's goals.

Product Characteristics

Regarding the evaluation category of product characteristics, candidates of both groups underlined a high importance of the product-market fit as well as product attributes with the potential for a competitive edge. This result is in line with the findings of Sandberg and Hofer (1987) who identified product differentiation as a crucial factor to attract venture financing. However, interview candidates of CVC funds revealed a stronger emphasis on this category, especially in terms of the product's strategic alignment with the parent organization's portfolio and strategic objectives. One interviewee explained that his CVC fund evaluates the venture's product in addition to the financial potential also in strategic terms, such as the compatibility with the portfolio of the parent corporation or its ability to enter a new market for the group. The results from the interviews suggest that this dual focus is only applicable for CVC funds as IVC interviewees underlined their primary goal in identifying scalable, disruptive products that have the potential for high returns, which aligns with the study of Stein and Topche (2021),

⁹ The cultural fit was exclusively described in the context of business culture.

who discussed the importance of growth prospects and product scalability for the investment decisions of IVCs. In contrast to this approach of quick scalability and potential first-mover advantages, which is also confirmed by the findings of Hellmann and Puri (2002), CVCs reported to have a higher focus on the long-term perspective of the products or services for the group. Additionally, several CVC candidates highlighted their preference for products that are already protected by IP, since founders are more willing to discuss technical details with the investor and in some cases specialized business units of the parent organization. This is supported by the findings of Dushnitsky and Shaver (2009) as well as Nadeau (2010) who explain the tendency of CVCs to invest in patent-protected technology and the signaling effects of IP that reduce information asymmetries. Overall, both type of investors have in common to value product characteristics that create so-called locked-in effects, especially applicable for software solutions, to increase switching costs for customers and achieve higher customer retention.

Applying these results to the first research question Q1 of this master thesis, one can conclude that the category of investment criteria regarding product characteristics is of higher importance for CVCs as for IVCs, since the latter does not apply a dual evaluation approach by including strategic considerations as well. Following the theoretical framework of the Resource Based View, this difference can be explained by a higher motivation of CVCs to enhance their parent organization's resource base with ventures that potentially provide strategically valuable assets for the group in addition to their standalone performance.

Market Characteristics

The interview results suggest that market-related criteria are evaluated as more important for IVCs as for CVCs. However, both types of venture investors assess criteria of this category as crucial for investment decision-making, as they consider factors like a sufficient market size and long-term viability. The result aligns with the studies of Eisele et al. (2011) as well as Tyebjee and Bruno (1984), who emphasize the market size and respective growth potential as a factor to attract venture funding. While interview candidates of IVC funds highlighted the aforementioned market criteria that build the foundation for ventures to achieve high growth rates, some CVCs tend to prefer markets where their corporate parent can leverage synergies, gain insights into new segments and expand the operations.

We also pay close attention to the scalability of the solution and how well it fits into the market, both in terms of customer demand and potential strategic synergies with [REDACTED] Group. – CVC 4

This approach resonates again with the RBV perspective on two different levels since, depending on their type of collaboration, both the corporate parent and the venture can benefit from each other's resource bases. This additionally provides the opportunity to evaluate ventures within the core domain of expertise, potentially more precisely. The findings of Brander and De Bettignies (2009) confirm this phenomenon of venture capitalists fostering unexploited opportunities in their principal area. In contrast, the results of IVC interviews indicate that their funds are more attracted by dynamic markets and open to investing in unfamiliar environments to tackle greenfield opportunities, especially when there are significant entry barriers for competitors. This concept of seeking out markets with substantial entry barriers aligns with the desire to capitalize on untapped potential, as discussed by Eisele et al. (2011). However, this approach might also involve higher information asymmetries, as investors do not have the same experience with the market environment and other influential factors. Eisele et al. (2011) further differentiates the importance of the investment criterion of market entry barriers, as their study only confirmed this behavior for US funds, not for VCs from the DACH area. This master's thesis includes interviews with funds investing in the DACH market, regardless of their headquarters location, which may explain why not all IVC candidates consider entry barriers a key factor.

Overall, the deviating focus of both investor types towards of market-related investment criteria contributes to answering the research question *Q1*, reflecting different strategic reasons based their organizational objectives and expertise.

Financial Traction

Candidates of both Corporate Venture Capital Funds and Independent Venture Capital Funds report a dedicated application of industry specific KPIs to evaluate the financial situation of the venture. As already stated by Dixon (1991), some of the interviewees underlined that the importance of financial criteria is increasing with the ongoing development of the venture, as the database gets more representative over time. However, candidates of both investor types highlight that the potential ROI is essential as VCs expect that the return of a few ventures

outweighs the failure of the majority of investments. While a number of KPI's is applied by both investor types, IVC candidates reported focusing thoroughly on traditional metrics like growth proxies, profitability and a stable cash flow situation to identify financial risks early on in the due diligence process. In addition to that, CVC interviewees stated to prioritize strategic benefits, like cost savings for the parent corporation, even if the venture is not yet profitable. This aligns with a study of Maula et al. (2005) and Chemmanur et al. (2014), who found that CVCs tend to value strategic benefits over immediate financial returns.

In any case, we look at the available figures, but it really makes sense from the Series A stage onwards. We apply the typical metrics like growth rates, EBITDA margin, R&D expenses, cash runway, burn rate, and so on. It's important that we always relate such metrics to the strategic advantages we would have with a stake. – CVC 1

Moreover, this behavior can be explained by the RBV as the venture not only contributes to financial returns but leverages the resource base of the group. In contrast, IVC candidates must evaluate ventures independently without strategic considerations that can equalize a lower financial performance. The essential requirement of sensitive valuations was underlined by an IVC interviewee, who explained that overpaying can have a lasting impact on the overall returns of the fund, as confirmed by the findings of Granz et al. (2020). This result also aligns with the Principal-Agent Theory since IVC funds operate for external LPs and have the duty to maximize financial returns within their scope of possibilities. Further, IVCs tend to prefer independent ventures, as one candidate revealed, which may explain why they rarely co-invest with CVCs, as their objectives are often misaligned and they miss out on strategic opportunities. Besides different approaches of performance metrics, some candidates also highlighted to analyze the capitalization table. In accordance to the results of Yung (2012), they argue that reputable investors can have signaling effects, as some kind of a second opinion that already approved the funding request. However, this can also result in herd behavior with increasing investment concentrations on potentially hyped industries.

Moreover, CVCs and IVCs underline the importance of the venture's cash flow situation, especially focusing on a sufficient cash runway until the next funding round, which, according to some interviewees, is a minimum of 12 months.

Overall, especially the answers of candidates from independent venture capital funds underlined their strong focus on financial criteria. Compared with the previous three evaluation categories, the IVC candidates also evaluated market characteristics and the management team with the highest importance. Therefore, this represents the preference of IVC investors to answer a part of research question *Q1*. On the other hand, some CVC candidates revealed a different evaluation approach for the financial situation, combining it with strategic effects for the group overall. The interviewees of this group evaluated the categories of the management team as well as product characteristics as most important, secondly financials and afterwards market characteristics. Their strategic perspective on ventures changes the situation of as a potential collaboration after the investment also impacts the requirements of a startup towards its environment.

Strategic fit for value-add services

Following with the results to answer the second research question, the interview candidates provided thorough information on value-added services offered to the ventures after the initial investment. While all interview candidates reported to provide these value-added services for the firms of their portfolio, the type of support deviated tremendously between IVCs and CVCs. Some funds consider the strategic fit of a venture to be able to receive and benefit from the services within the investment evaluation.

Overall, CVC interview candidates highlighted to put a greater emphasis on the strategic fit for the value-add services, sometimes even with the requirement of a strategic partnership with the corporate parent organization. Maula et al. (2005) confirms this phenomenon with her study, as she found that CVCs focus on leveraging the group's resources and market access to support startups. Some CVCs evaluate this strategic alignment as essential for maximized mutual benefits, enhancing the firm resources of the venture as well as the parent organization aligning with the RBV. Moreover, the interviews reveal different types of support for the startups. CVCs provide more specialized support, sometimes through dedicated business units offering technical assistance and product development resources. These findings are supported by Maula et al. (2005), who emphasizes in her study the technical support of CVCs and their support through networks. In addition, one CVC candidate also stated that ventures can further be supported in the role of a customer or supplier of the parent organization.

“Sometimes our LP expects a mandate with our group that is contractually binding for the venture. Depending on the individual case, this could put the venture in a customer or supply role to [REDACTED].” – CVC 2

Additionally, the interviews provide evidence that some startups tend to be cautious when engaging with CVCs. Candidates report that ventures are only willing to provide full technical details once the innovation is protected by IP, due to the fear of imitation. This *Paradox of Corporate Capital*, as presented by Dushnitsky and Shaver (2009), is partially reflected in the interviews. As a consequence, interviewees reported focusing more on startups with filed IP protection or ventures in later stages that do not fear imitation anymore. This indicates a shift in CVC strategy to avoid conflicts and align more closely with ventures that can safely integrate with the parent’s strategic goals.

In contrast, IVC interviewees reported that their funds typically provide broader consultancy services for the ventures, supporting them on strategic, organizational, and financial topics. One IVC candidate revealed that his fund is providing additionally industry expertise with dedicated teams, indicating a more operative approach. Nevertheless, these instruments often do not require any strategic alignment. In addition, IVC candidates reveal that their funds aim to provide portfolio firms network access and active support for fundraising as well as exit preparations, which underlines the focus on potential financial return. These efforts can further be evaluated as operational risk mitigation of the funds, serving the interest of their principal (i.e., Limited Partners) by applying the Principal-Agent theory.

Overall, both types of VC investors have various instruments to provide ventures post-investment support. While the respective support is part of the investment strategy and can require significant resources, the investors also consider the strategic fit of startups to be able to receive and benefit from these programs. Answering the second research question *Q2*, interviewees also provided further information on the strategic fit and its influence on the evaluation criteria to assess potential investments. Candidates from IVC funds reported their openness to support ventures, while this voluntary option, which does not influence their willingness to invest, assumed that all other criteria match their expectations. On the other hand, CVCs highlighted the high importance of the strategic fit as this shifts the risk profile of their ventures significantly, having the parent organization as a new potential customer that elevates

the startup's growth prospects. This also results in a higher perceived attractiveness for an investment from a CVCs perspective.

Exit

Regarding the third research question *Q3*, candidates from both CVCs and IVCs revealed to consider exit strategies as part of their initial evaluation of the funding request, which aligns with findings from the literature (Mason & Stark, 2004; Useche & Pommet, 2021). However, compared to the other categories of investment criteria, interviewees of both groups only expressed a lower level of relevance of this factor for their funding decision. Only one IVC interviewee emphasized a high importance of this criterion, further explaining that his fund already had cases where they had potential partners for a future acquisition during the initial evaluation, delivering a compelling exit scenario for his IC. This also links to the study of Mason and Stark (2004), who points out the preference of IVCs having a predetermined exit scenario. Overall, most IVC candidates stated to favor IPOs or trade sales, ultimately depending on what provides the highest financial return which aligns with the Principal-Agent theory that the fund management as an agent aims for utility maximization.

“It depends on the case. An IPO would be ideal, but trade sales are also possible. It depends on the best value for the company.” – IVC 1

However, the market conditions can significantly influence the exit strategy, as one interviewee stated that the preference of his fund changed from IPOs to private transactions due to the evolving market environment.

“The most common exit methods are trade sales and, occasionally, secondaries. IPOs have become rare due to the current market situation, but they remain prestigious.” – IVC 4

CVCs in contrast report to place a lower emphasis on liquidity-oriented exits, like IPOs or trade sales. Some candidates highlight that their funds aim for a potential future integration of the ventures following strategic objectives. This is in line with the findings of Useche and Pommet (2021) who found in their study this preference of CVCs to integrate portfolio firms into larger corporate ecosystems of the group. This observation further links to the RBV that CVCs use

ventures to enhance their internal resource base. Some scholars further differentiated between exit preferences of CVCs depending on the type of the parent organization. However, this was not reflected with the interview results. A possible reason is the mix of CVCs with parent organizations from different industries that are included in the sample of this master thesis.

Overall, the results of the interviews underline the relevance of exit scenarios also as part of the initial investment evaluation. Answering research question *Q3*, both VC investor types have clearly different objectives for their preferred exits. While CVCs aim for strategic integrations and mergers, IVCs pursue liquidity-oriented exit routes aiming for the highest possible financial returns.

In addition to the aforementioned results, one interview candidate further highlighted the emerging importance of ESG criteria as an increasing number of Limited Partners emphasize this factor as well. Furthermore, another candidate highlighted the rising importance of cybersecurity applications and defencetech at the software level as well as there is a push in Austria for firms to engage more in VC funding.

5.2 Limitations

The sample for this study includes a composition of industry-leading VC funds from the DACH region. However, the size of the sample might not capture the whole diversity of the CVCs and IVCs. In addition, a higher sample size would also allow for a higher differentiation of the strategies and respective investment criteria. Moreover, the selection of industry professionals who are partly from the direct network of the author might also come along with a selection bias as these connections might share similar perspectives on certain preferences of investment evaluation factors. As VC professionals are difficult to reach, this master thesis might exclude the opinion of additional high-profile experts and therefore missed additional contributions that could have been valuable. Furthermore, the scope of the thesis is limited to VC firms that invest in the DACH area on firms that target ventures with software business models. This entails that the results are not necessarily applicable to other geographic areas as the investment behaviors differ, as previous researchers found (Mayer et al., 2003). Additionally, the results only represent investment criteria of VC firms with software business models which might not be generalizable for other industries because of certain typical characteristics like a low level of

capital expenditures and assets. The chosen methodology of this master thesis with the analysis of semi-structured interviews includes a subjective element.

Overall, it is important to acknowledge the limitations to evaluate the results in the right context. However, as these factors were considered to minimize the potential impact as much as possible.

5.3 Practical Implications

The results of this thesis provide valuable insights to investment preferences of Independent Venture Capital Funds and Corporate Venture Capital Funds. Especially for early-stage founders aiming for fundraising in the DACH region, the findings of this master thesis help on various levels to position the venture to increase the likelihood to fulfill the requirements of VC funds. It further depends on the preferences of the founder and the startup to aim an alignment either with the target criteria of IVCs or CVCs. Regarding the management criteria, startups should emphasize on the leadership abilities as well as the track record of the teams due to the preferences of IVCs. For a pitch with a CVC, the management should underline especially its technological expertise. It could be also beneficial to highlight past success in competitive environments as well as previous working experience with corporates.

Regarding the product characteristics, startups should underline the product-market fit. Ventures targeting IVCs should focus on the scalability and the disruptive potential of the product, whereas startups focusing on CVCs should rather focus on the strategic fit in the group.

Ventures should further put an emphasis on market factors like the size and overall growth potential for IVCs, while they should highlight on presenting the potential for synergies, transfer of information and access to new markets during CVC pitches.

Furthermore, startups should evaluate whether they can benefit from certain resources, such as business advisory or technical support, with the potential to collaborate with a corporate entity. In terms of the exit scenario, a startup should take into consideration that the presented exit plan might be assessed by the VC as an additional criterion for the investment. Therefore, founders should inform themselves previously about respective exit preferences of the funds they apply to.

6 Conclusion

This master thesis aims to provide a comparative analysis of the most relevant investment criteria of Independent Venture Capital Funds and Corporate Venture Capital Funds that target early-stage ventures investing in software business models in the DACH area. The study analyzed potential differences of the perceived importance on investment criteria between the two groups of VC investors to provide guidance for founders seeking fundraising but also to industry researchers and policy-makers to present new perspectives on the market.

Overall, the results suggest that ICVs and CVCs investing in DACH-based early-stage firms tend to have the highest focus on criteria of the category of the management team. While CVCs further assess significant importance to characteristics of the product, IVCs rather prioritize a deep analysis of the market and of financial figures. Consequently, the results indicate that IVCs receive the same share for smaller investments with higher pressure for performance whereas CVCs consider additional strategic objectives.

Both types of investors have different approaches in supporting their portfolio ventures after the initial investment with non-financial instruments. IVCs offer mainly business advisory services, while CVCs offer, depending on the capacities of the overall group, technical support for the development of products, the integration in the group's operations in the form of supply, or customer relationships. The strategic objectives of CVCs are also reflected in their exit preferences, as some already consider potential acquisitions at the time of the initial investment. IVCs prefer the scenario of the highest return, having already potential partners for a later exit in their network or actively supporting the ventures in pursuing IPOs.

Future Research

This study provides new perspectives on the different investment criteria of Independent Venture Capital Funds and Corporate Venture Capital Funds. The results can serve as a knowledge base for future researchers. In particular, the investment criteria that were compared in terms of priority for the respective types of VC funds can be analyzed in more detail independently. For the field of management teams, scholars might conduct additional studies on the evaluation of previous negative funding experience of entrepreneurs and how this assessment might differ between CVCs and IVCs, taking into consideration the different cultural background of both investor types. Alternatively, researchers could investigate on

systems how to measure financially strategic benefits from CVC investments, also for having a realistic data foundation for the comparison to IVC fund performance. In addition, scholars might analyze the different impact of provided value-add services from ICVs and CVCs on the financial performance of ventures.

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8 Appendix

8.1 A: Interview Guideline

Background and Role	
<p>Can you please briefly overview your background and current role within your organization?</p> <p>How long have you been involved in venture capital investments/the industry?</p>	<p><i>Validation that interviewee is a qualified expert in the field of VC financing</i></p>
General Information on the VC Fund	
<p>Would you categorize the VC fund you work for as an Independent Venture Capital Fund, meaning there is no controlling influence, either through decision-making power or through capital provided by a single corporate or government?</p> <p>If not, is there a strategic mandate by the entity in control that could influence the investment criteria directly or indirectly throughout the operations? What are the main goals for this controlled venture capital vehicle?</p> <p>What is your structural connection to the controlling corporate? (e.g. internally via their balance sheet, internally via a separate vehicle, externally via a subsidiary)</p>	<p><i>Check for IVC vs. CVC</i></p> <p><i>Develop an understanding of the VC structure</i></p>

<p>Who are the key stakeholders involved in the investment decision-making process? (What are the involved hierarchy levels, and who has decision-making power?) <i>(develop an understanding of who drives decisions within the company)</i></p>		
Investment Criteria		
<p>Since this study aims to generate insights how the different strategic alignment of CVCs and IVCs impact the respective investment criteria, I will ask you in the following part of the interview about the investment preferences and criteria of your VC fund.</p>		
General Investment Focus		
<p>What is the investment thesis of the fund?</p> <p>Can you describe the main focus of your investment activities in terms of industry, development stages and geographical regions?</p> <p>Do you invest in software companies? Is there a specific reason why your fund invests in software companies?</p>	<p><i>Validate the investment focus (DACH & Early Stage - software)</i></p>	
Investment Metrics	<i>Hypotheses testing</i>	<i>Coding</i>
<p>Can you describe the primary criteria your firm uses when evaluating potential investment opportunities?</p> <p>Which criteria are most important to evaluate the investment decision?</p> <p>How important are risk-limiting clauses for you?</p> <p>Are you usually requiring more or less risk-limiting clauses during funding rounds than other VCs of this transaction?</p>	<p><i>H1</i></p> <p><i>H1</i></p> <p><i>General insights</i></p>	<p><i>Management Team</i></p> <p><i>Product Characteristics</i></p> <p><i>Market Characteristics</i></p> <p><i>Financial Traction</i></p>

Ability of non-financial support	<i>Hypotheses testing</i>	<i>Coding</i>
How do you support your portfolio companies post-investment?	<i>H2</i>	<i>Network support Operational support Business Advisory Marketing/Fundraising Technical Support Customer Relationship</i>
What are the main reasons for this support?	<i>H2</i>	
In comparison to other VCs, would you say that you provide more support to your portfolio companies?	<i>H2</i>	
Does the ability/fit to support startups influence your investment criteria?	<i>H2</i>	
Exit	<i>Hypotheses testing</i>	<i>Coding</i>
What is your maximum investment horizon? If this varies between different funds, please provide me with an estimate for the average.	<i>General insights</i>	<i>Liquidity-Return options vs. strategic options</i>
What is the reason for this investment horizon?	<i>H3</i>	
What is your preferred exit scenario?	<i>H3</i>	
How does this preference influence your investment criteria?		
Future Outlook		
How do you see the role of CVC and independent VC funds evolving over the next five to ten years?	<i>General insights</i>	
What changes do you anticipate in investment criteria and strategies?		

8.2 B: Expert Interviews

The detailed interview transcripts are available on request.

Interview 1: July 10th, 2024, 3PM – CVC 1

Interview 2: July 15th, 2024, 1:30PM via Microsoft Teams – IVC 1

Interview 3: July 23rd, 2024, 3:36PM via Microsoft Teams – CVC 2

Interview 4: July 24th, 2024, 5:30PM via Microsoft Teams – IVC 2

Interview 5: July 25th, 2024, 9:30AM via Microsoft Teams – IVC 3

Interview 6: July 26th, 2024, 11:30AM via Microsoft Teams - IVC4

Interview 7: August, 2nd, 2024, 10AM via Microsoft Teams – CVC3

Interview 8: September 05th, 2024, 09am via Microsoft Teams – IVC5

Interview 9: September 5th, 2024, 11:30AM via Microsoft Teams – CVC4