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THE TURNING POINT OF FREE MONEY IN THE MARKET –
CHALLENGES AND OPPORTUNITIES FOR VENTURE CAPITAL

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Abstract

This work project presents how VCs need to adapt their VC Investment Process to benefit from emerging ecosystems. Based on interviews with VCs, Business Angels and Venture Builder, changes on market characteristics, activities, responsibilities were analyzed, and three key themes were identified. The study outlines factors on how Venture Capitalists adapt their screening methods to overcome challenges and capitalize on opportunities. Practice displays that stakeholder need to increase activities and shift decision-makings. Based on the findings, data analysis, and the practical implications and contribution of the research provide a view on how VC companies need to cope with emerging ecosystems.

Keywords: Venture Capital, Deal Screening, Venture Selection Process, Venture Capital Ecosystem, Entrepreneurial Finance

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1. Introduction

The word turning point (*Zeitenwende*) is the word of the year 2022 in Germany (Spiegel, 2022). There are several reasons for this. The macroeconomic events that have a particular impact on the economy this year have heralded a turning point not only politically but also economically. Thus, also on public markets and the ecosystem venture capital. Therefore, it becomes crucial to understand how venture capital ecosystem depends on the ability of VC firms to identify and invest to succeed against peers in the market. This requires VC firms to have a deep understanding of the market trends and opportunities in their target industries, as well as the ability to evaluate the potential of individual start-ups. Additionally, the venture capital ecosystem is constantly evolving, with new technologies and business models emerging all the time (Harrison & Mason, 2019).

The following structure is used to comprehend this. The chapter begins with an overview of the subject area and associated research gap that results from the generated research question, followed by a description of the project's goal and method of inquiry before concluding with the project's structure.

Second, the examination of the relevant literature identifies and explains the history of the venture capital ecosystems as well as the shifts in the roles that have occurred in light of recent developments. In this way, we will outline the challenges and develop our hypothesis.

Third, the methodology explains in a generic approach how the conclusions and the data analysis are constructed; these are the things that are written down subsequently.

Fourth, a discussion of how the results and data add to our understanding of the theoretical framework is offered.

Fifth, the work project will culminate with a discussion of results, consequences, contributions for practitioners, and future research before concluding the master thesis with emergent limits, a request for more study, and concluding remarks.

1.1 Introduction to the Topic

What investors seek is quite intuitive: a profitable exit. Either they strive for an internal rate of return that is a certain percentage, or they want a return that is equivalent to some multiple of their original investment (Kaplan & Schoar, 2005). To fulfil this goal over time market players, have repeatedly trusted Venture Capital funds (VC) to invest their money into upcoming business opportunities (DePamphilis, 2011). VC companies often hunt for businesses that are inventive, fast developing, and focused on technology. In exchange for a minority stock share, the firms provide the entrepreneurs cash and guidance. This is how most successful technology businesses of today originally acquired significant capital (Dushnitsky & Lenox, 2006). For instance, Airbnb was able to secure \$7.8 million in a round of funding in 2010 from venture capital firms such as Greylock and Sequoia Capital (*Airbnb the Unicorn*, 2018). Thus, the VC industry is cherished throughout the world as an engine of economic growth in the past years (Zider, 1998).

In today's fast-paced world, the maximum development of value is reliant on the ever-increasing impacts of management strategies, ideas, and skills. In order to create this value, organizations are progressively extending far beyond their traditional boundaries and walls (Teece 2007; Tsujimoto et al. 2018). Therewith, the increased interconnectivity of portfolio companies and possible targets, driving funds to even more precise evaluation of industries, assessments of deal screenings and identification of further risks in the VC investment process (Appendix A). Studies researched that fund's structure their findings across four distinct categories such as market potential, management, competition, and product (Tyebjee & Bruno, 1984). However, VCs operate and target in different industries and at other investment stages

of entrepreneurial firms, therefore evaluation procedures and the weights they assign to be important may vary substantially (Macmillan et al., 1985).

The financial conditions provided by the institutions have accelerated and supported growth since the great financial crisis in 2008. Although COVID have impacted companies' economical situations beyond the VC ecosystem, we have noticed in 2021 a record year for VC financed companies reaching valuation above one billion dollars (unicorns) (Moonfare, 2022). Macroeconomic crisis has been tackled by VCs in the past with great resistance. The entrepreneurial landscape has seen each crisis as a chance to disrupt the market and create enterprises that are particularly adapted to the emerging business environment (Monika & Sharma, 2015a). The responsibility of venture capital funds was and is to determine the degree to which these enterprises have the potential for long-term success. Thus, venture capitalists and entrepreneurs are mutually reliant in their connection which further increases the importance of right evaluation criteria (Harrison & Mason, 2019).

The war in Ukraine has shifted views of experts on macroeconomic events. Increasing prices and interest rates, volatility on the global financial markets, and persistent supply chain issues all contribute to a decline in investment activity. As a result, venture capital investors are becoming more cautious. Moreover, all of this transpires against the background of deteriorating public market performance. This has affected venture capital transaction sizes and valuations (Gompers et al., 2008). It will be crucial to understand what factors will become increasingly important for assessing entrepreneurs and their firms in high volatile and unstable markets.

1.2 Research Gap and Aim of Project

Current developments in the area of finance for venture capital funds and entrepreneurs in the ecosystem have emerged and alerted as a subject of interest in all sectors (Klonowski, 2022). Over the last decade, the emphasis of study has been on the strategic value of VC company

valuation approaches, with data indicating that funds give important non-financial resources and competencies to the ventures in which they participate (Buzzacchi et al., 2015; Macmillan et al., 1993.; Monika & Sharma, 2015). In addition, the rising knowledge that human capital as a resource sets the basis for successful start-ups has improved venture capital funds' emphasis and recognition, as well as their strategy (Zarutskie, 2010).

However, scholars have not yet looked closely at how the venture capital ecosystem needs to change with the new implemented interest rate policies across the world that have a major impact on portfolio companies and potential targets. In the past, papers have already elaborated on the investment cycles influenced and the impact of public markets from a financial point of view (Bacon, 2012; Gompers et al., 2008). While the importance of qualitative factors, such as the importance of the skillset and the educational background of entrepreneurs, has been studied across other multiple papers (Klonowski, 2022; Monika & Sharma, 2015a; Tyebjee & Bruno, 1984) . Previous research failed to use an agile approach that facilitates the reordering of quantitative and qualitative criteria throughout the VC investment decision and screening stages. The decrease in valuations, for several high growth start-ups (e.g., Gorilla and Revolut) in the previous months of the crisis, have strengthened the demand to reassess current VC practices (Handelsblatt, 2022). Future sustainable growth opportunities, competitive advantages across peers and healthy entrepreneurial landscapes can only be achieved by understanding the fundamental misconceptions in the decision-making process when evaluating potential target investments.

The purpose of the project is to add value to current work and bridge the aforementioned research gap. Consequently, the objective of this study is to respond to the following research question:

“How should Venture Capitalists adapt their screening methods to overcome challenges and capitalize on opportunities?”

To properly elaborate on the research question, the theoretical background on the venture capital ecosystem will be discussed and the emerging market conditions will be put into context. Thereby developing a holistically understanding of the current challenges.

2. Literature Review

Within the venture capital ecosystem and across the entrepreneurial finance business, the notion of the Venture Selection process has garnered increasing attention as industry leaders and players have adopted new approaches to generate and capture value. Due to the disastrous macroeconomic effects that are affecting all economic stakeholders, people involved must be aware of the quick disruptions in the process and company. Understanding the influence of quantitative and qualitative components has become essential for identifying appropriate objectives. Thus, the driving factors of venture capital investments have seen substantial expansion in business and academic publications to cope with future challenges (Klonowski, 2022).

This chapter is organized as follows. First, a general understanding of the literature on venture capital ecosystems, the evolution of their key features, and the different views are described, capturing current concepts and research objects. The second section addresses the geopolitical impact on the venture capital industry by looking at deal flow, portfolio, and observed changes in the financing environment. The third section looks at the adjustments in the emerging VC ecosystems, specifically addressing the challenges and opportunities. Finally, hypothesis are defined and will later be explored and investigated in the discussion part of the thesis.

2.1 Theoretical Background on the Venture Capital Ecosystem

2.1.1 The evolution of Venture Capital investments

As described in various papers, the ecosystem around venture capital has undergone tremendous change in recent decades, with the expansion of the internet and the proliferation of technology VC funds playing a big part in this change (Caselli Stefano & Negri Giulia, 2021). Therefore, in the early days of venture capital, the primary focus was on offering financial support to already established businesses with the intention of either expanding their operations or developing new goods (Gompers & Lerner, 2001). This most commonly took the form of expansion capital, which enabled businesses to make investments in new items of equipment, hire extra people, or enter new markets. However, due to the development of the internet and other technologies, venture capital firms have shifted their focus to financing early-stage startups that are developing innovative technologies or business models (Ewens et al., 2018; Nanda & Rhodes-Kropf, 2013). This shift has occurred as a direct result of the developments. Due to this, there has been a rise in the amount of seed money and early-stage venture capital available to assist new businesses in the development of their goods and technology (Zider, 1998).

Historically, venture money bridges the financial gap between sources of finance for innovation and traditional, lower-cost forms of capital available to existing enterprises. To properly fill this need, the venture capital business must provide a sufficient return on capital to attract private equity funds, attractive returns for its own investors, and significant upside potential for entrepreneurs to attract top-quality ventures with high returns (Bottazzi & da Rin, 2002). As a result, the difficulty is to earn returns on investments in fundamentally risky ventures (DePamphilis, 2011). Consequently, the VC industry's extreme volatility is widely recognised. This volatility presents itself in several ways, including the flow of funds to venture capital firms, the investments made by businesses in portfolio companies, and the financial

performance of portfolio companies and venture capital firms (Gompers and Lerner, 2004). Considering, Mason (2009) recognized that Limited Partners and VCs have a classic principal-agent problem (Appendix B). Since, VCs are investing with collected funds they have a high risk and an even higher responsibility to use the money properly. Therefore, venture selection processes have evolved over time to maximize success.

2.1.2 Most relevant features of Venture Capital Selection Process

Mason (2009) clusters the venture capitalists' investing process having the goal to minimize two categories of risks. Firstly, he refers to adverse selection. Due to information asymmetries, the entrepreneur knows more about his capabilities and his company than the potential investor does, which creates a risk for the investor to invest in companies with low-quality products or services. Furthermore, adverse selection also creates a conflict of interest between the entrepreneur and the potential investor (Glücksman, 2020).

Secondly Mason (2009) defines the danger of entrepreneurs to engage in activity that is more beneficial to the entrepreneur's own interests than those of the investor is known which is known as moral hazard. VC firms typically follow a specific investment process when evaluating potential investments. Therefore, Tyebjee & Bruno (1984) have suggested a five-segment VC investment process by conducting market research, analyzing the business model and financial projections of the startup, and conducting due diligence to assess the risks and potential rewards of the investment. Primary goal of the implementation is to increase the preassessment of start-ups and ease the decision-making process (Appendix A). Thereby, previous paper has concentrated on a variety on qualitative factors. According to Morrissette (2007), the bulk of investment criteria include the entrepreneur. These characteristics include the entrepreneur's excitement, integrity, experience, and product's potential for sale. Important additional evaluation factors include management quality, development potential, and entrance

hurdles. Hindle and Wenban (1999) and Aizenman and Kendall (2008) discovered that location was crucial for minimising travel costs. Hindle and Wenban found that the quantity of capital spent, and the time horizon were significant. In addition, Batjargal and Liu (2004) said that an acceptable net present value is a crucial criterion for selection. In addition, the deal's advantages and disadvantages, controls, development phase, financing requirements, founder ambitions, liquidity, and exit were considered critical. When it comes to new enterprises, venture capitalists and the entrepreneurs they assist face a substantial selection risk, which encompasses the company's market, product, and technical potential; as well as its management competencies (Batjargal and Liu, 2004). Moreover, Petty and Gruber (2011) show that these stylized behaviors may vary based on the various phases or rounds of investment. Furthermore, according to Muzyka, Birley, and Leleux (1996) and Franke et al. (2008), the completeness of a new venture management team is a major issue to venture investors. They are particularly concerned with two aspects of the team: its completeness and balance (heterogeneity). All the above-mentioned factors from the literature have shaped the VC selection process in recent years and brought it significantly forward. Further, in the next part the latest studies have to be discussed which disruptions the VC ecosystem had to go through in the last months and which relevance it has for the selection process.

2.2 Impact of current geopolitical & macroeconomic environment

Recent geopolitical turbulences have reopened the pandemic's economic wounds and placed additional strain on European markets (International Monetary Fund, 2022). Geopolitical tensions and macroeconomic growth have been identified as the most significant danger to the investment environment (European Tech Report, 2022). The geopolitical issue has generated a serious energy crisis in Europe, a dramatic rise in the cost of living, and diminished economic activity, which led to an overall increase of inflation. This will be attempted to be reduced

by raising interest rates for the first time since the 2008 global financial crisis (International Monetary Fund, 2022). Due to this, the state of the market has caused a shift in sentiment among VCs, and as a result, new patterns of behaviour and tendencies are becoming more noticeable. A decline in the performance of public markets exerts pressure on the venture capital market, which in turn leads to falling multiples, which in turn leads to falling valuations of firms (Caselli Stefano & Negri Giulia, 2021; Gompers et al., 2008; Klonowski, 2022). As a direct consequence of this, the requirements for early venture capital investments have gotten stricter. It is anticipated that the supply of venture capital investment and the demand for it will continue to diverge, so creating an imbalance that will give rise to new market dynamics (EIF, 2022).

Changes in three sectors of the venture capital business have resulted from the difficult market situation. Venture capitalists determine their deal flow, they give special emphasize on their portfolio companies and additionally there is more financing activity. It can be examined that a conservative investment approach affects the current deal flow. VCs new selection criteria support the investment choice in this setting. During recent years, we have seen an increase in high-growth start-ups that have substantial capital burn (e.g., Gorillas) (Handelsblatt, 2022) . The cheap cost of money that was available has made it feasible to finance these endeavours, and venture investing has been rewarded by a number of mega fundraising rounds that have led to significant rises in value. Due to the volatility of the market, the desire for alternative asset classes and typically greater scalability is no longer the primary element that determines outcomes (Achleitner et al., 2013; Buzzacchi et al., 2015). This preference came about as a direct result of rising interest rates. Due to the present state of the market, venture capitalists are increasing the amount of scrutiny they apply to potential investments. The venture capital industry focuses its selection criteria for new investments on financial parameters. The ability to generate cash and profitability come in second and third, respectively, behind valuation as the most essential aspect (EIF, 2022). Therefore, in their

investment proposals, start-up businesses need to be able to demonstrate a clear route to profitability in order to attract potential investors (Monika & Sharma, 2015b). In addition, venture capitalists are not required to make the newly obtained funds accessible on the market immediately and instead have the flexibility to handle it in a more restricted manner. Consequently, the market has to be capable of surviving the transition during the economic slump while having less capital (Rosenbloom, 2022). Current events demonstrate how significant the implications of such a lengthy period of negative interest rates were, which is why it remains intriguing to see what conclusions governmental institutions make and what steps they continue to take, given that the issue is ongoing transformation (Kubiczek, 2022).

2.3 Adaptations in the emerging VC Ecosystems

The venture capital ecosystem is undergoing a complete transformation in the analysis of what in past years were basic rules and procedures as presented in the two sections seen earlier. As a result, it is facing major challenges. Firstly, it needs to clarify which will be the guiding factors which can be seen as success factors when screening the market. Secondly, when the funding activities slow down, VCs will focus more on their portfolio companies. There is a need to clarify how VCs plan to do this. Finally, there are differences in the validation of seed, early- and late-stage fundings. The two sections of the literature review give the theoretical framework, understanding and the now identified challenges. Therefore, the following hypotheses arise which will be answered in the course of the thesis.

H1: Quantitative measurements become more important than qualitative factors in the Deal Screening

H2: Seed funding and Early-stage activities are not as influenced from the funding challenges

H3: The pullback of funding will result in slower fund deployment times of VCs

3. Methodology

The previous parts have provided an analysis of the research question and related examination of existing literature on concepts of VC evaluation methods. This chapter focuses on the methods applied in this master thesis.

3.1 Research Method

This study employs a qualitative research methodology and focuses on the association between prior theoretical literature, contemporary literature, and ubiquitous views to give a solid foundation for analysis and conclusion drafting (Yin 2009). To achieve the stated purpose, a qualitative interview technique including in-depth interviews was used to acquire a practical perspective on the VC ecosystem. This is utilized to advance relevant facts and insights for future discoveries and outcomes (Cassell and Symon 2004). The qualitative research insights are used to obtain detailed information on real-world situations and to help understand the phenomenon to provide a fundamental analysis of intentions, behaviours, experiences, and predictions that are pertinent to the context of the research approach (Sinkovics and Alfoldi 2012).

3.2 Data Collection Method and Evaluation

According to Monika and Sharma (2015), qualitative research methods and in-depth interviews have been used in the past to study venture capital and entrepreneurial financing. Therefore, in-depth interviews with eight persons were conducted from a neopositivist perspective to ensure neutrality and dependability devoid of hypotheses or biases (Welch and Piekkari 2006). This improves data collection quality and delivers objective insights.

Partners in in-depth interviews come from a variety of organisations and sectors. Moreover, they are all German and act internationally. It is an appropriate strategy to utilise

data and information across sectors based on the range of roles to ensure the high quality of common findings and construct a solid foundation when little qualitative research has been conducted in the past (Yin 2009). Within the research design of this thesis, participating companies need to be actively involved and influenced by the current developments in the ecosystem. Thereby, considering employees and partners of venture capital funds, business angels, employees of venture builder (Appendix C). Based on the deliberate sample, the people were contacted via private connections (Robinson 2014). The semi-structured interviews with 15 predetermined open-ended questions in the questionnaire were answered within a 30- to 45-minute video or phone call interview due to geographical dispersion and were conducted via Zoom/Microsoft Teams as this became a viable option as a result of recent technological developments (Janghorban, Roudsari, and Taghipour 2014). The aforementioned information is the outcome of the interview partner's accessibility and practicability. The interview guide is available in Appendix D. In addition, an examination of internal company papers was used to enrich the findings. However, individual questions, subjects, and follow-up questions were modified in response to the expert responses. The respondents were chosen on the basis of their background, experience, and connection to the current developments in the VC ecosystem. Based on the eight interviews conducted between November 2022 and December 2022, data collection and assessment were conducted. Thus, the interviews were analysed using a descriptive coding technique that was completed manually (Saldana, 2015). Based on predetermined interview questions and current literature categories, the coding process groups interview material into many themes. These are produced based on the commonalities of links between themes, job domains, ambiguities in traits, and role profiles. Consequently, they were grouped into groups in order to fulfil the study aim, the thesis goal, and provide unbiased data (Percy, Kostere, and Kostere, 2015) (see Appendix E). In addition, the technique of thematic analysis has been used to ensure quality improvement measures and validate the categories and

themes (Braun and Clarke 2006). Thus, the interviews were analysed using a descriptive coding technique that was completed by hand (Saldana 2015). Based on predetermined interview questions and current literature categories, the coding process groups the interview material into many clusters. These are produced based on the commonalities of links between themes, job domains. Therefore, they were grouped into groups to fulfil the study aim, the thesis goal, and provide unbiased data (Appendix E) (Percy, Kostere, and Kostere, 2015). Furthermore, the method of thematic analysis has been used to guarantee quality improvement measures and verify the categories and themes (Braun and Clarke 2006).

4. Findings & Data Analysis

This chapter discusses the conclusions of this thesis based on the produced data and is arranged into three separate primary themes, followed by sub-topics that assist the analysis of the study goal across the examined players in the VC ecosystem. The essential insights and information come from the interviews, which are based on the experiences and knowledge of the interviewees. Furthermore, the link between the literature evaluation and providing a response to the research question is emphasized in the discussion part.

4.1 Theme 1: Characteristics of macroeconomic developments

Interviewees across all positions recognized the shift in the financial market, whether they work for VC funds, execute deals as business angels or support ventures as an employee in a venture builder. *“There are indications that increased interest rates led to a worsening in the fundraising environment, lower firm valuations, and eventual portfolio write-downs”* (VC employee 01). Furthermore, the negative developments led to *“increased risk aversion of LPs, LPs exiting the market, higher interest rates, and growing levels of inflation”* (VC employee 02). Thereby, interview partners described with regard to the limited partners two transformations *“Banks, insurance companies, high-net-worth people, and pension funds, in particular, are eager to transfer their holdings away from venture capital funds and onto the public market”* (VC employee 01). Furthermore, *“family offices and corporate investors seem to have a (much) reduced inclination to engage in VC”* (VC employee 01). Among the interview partners it became apparent that the rise in interest rates across the globe have not been expected *“the nominal negative interest rate since the financial crisis has distorted our concept of fundraising”*(Business angel 01). When asked about the most significant obstacles that the venture capital ecosystem would face in the next years, a large number of them cited the macro risks that were rated the top by respondents: interest rates, inflation, and geopolitics.

The mood regarding the extent to which the economic situation will change is viewed in a mixed light. On the one hand, the following aspects give rise to doubts *“it is not only about funding and locating new startups. Exit possibilities for our present portfolio firms, as well as access to capital for new portfolio companies, will become more challenging* (VC employee 03) and *“market valuation of unicorns and other start-ups decreased further”* (VC employee 02). On the other hand, respondents differentiated between early and later stage fundings, since *“plenty of financings still happening at the seed level... because seed firms are six-ten years away from a substantial exit and no one knows where the market will be at that time”* (Business angel 02). Lastly Venture builder 01 refers to the fundamentals of entrepreneurial funding. Since limited partners and venture capital companies launched funds before to the crisis, money is simply not being circulated in the market right now since it has become more costly, making start-up valuations more critical. Therefore, confidence among the VC ecosystem players exists when considering the long-term perspective of the funding environment.

4.2 Factors Required for VC Pre-Investment Process

Before discussing the factors needed for the VC screening process, including necessary competencies and activities, it is important to note that all respondents reported a continual evolution and smart transformation process, which have an impact on the following aspects.

4.2.1 Factor 1: Assessment of Sustainable Market Potential

When examining possible metrics to properly analyse targets and therewith assessing valuations techniques respondents throughout all practices agreed that *“valuations in the past were “detached from actual values and increasingly concerned with what potential could be achieved with total market dominance”* (VC employee 04). Especially disruptive innovations and business plans by start-ups were overestimated *“classic business models and already*

established market players were ignored as long as the potential of the market was significantly high with the purpose of becoming the new Uber or Airbnb in the end” (VC employee 01). The new market environment shows that growth is no longer the predominant variable when evaluating a business case of a potential target or the already acquired portfolio companies. *“You can feel that everyone in the market is more sensitive to money because they realise that the crisis could last longer than first thought”* (Venture builder 02). Due to that, VC’s will concentrate more on targets who can early on present positive cash-flow streams and the screening will concentrate more on the financial actual burning rates of cash instead of the growth potential which would be necessary to become profitable. Venture builder 01 supports this shift in strategy, since *“it reflects still growth as an important metric but is now evaluated as sustainable growth”*.

4.2.2 Factor 2: Skillset Needs for Entrepreneurial Management Teams

Besides the complex macroeconomic developments, the variable human capital is still be assessed as the most crucial success determinant for start-ups (Venture builder 01). VC employee 03 states that *“in a good market environment a lot of entrepreneurs and good ideas will have success and achieve high valuations”*. Therefore, founders need to be good at prioritizing and anticipating future trends. Especially experienced leaders, who have already been through a comparing financial crisis, are more in demand than ever (Business angel 01). This shows that screening processes are coming back to their fundamental values and a real conservative crisis manager is being sought. When concentrating on the adaptation of these roles, it becomes evident that the individual must be *“decisive, goal-driven, flexible an excellent communicator and cool-headed excellent listener”* (Venture builder 02). Furthermore, the respondents confirmed how eminently important the educational experience is in the context *“the higher the academic degrees, the more likely the potential to have good crisis managers*

and thus positively influence on the firm dynamics”. With underlining the beforementioned aspect, the foundation for combating the current VC business ecosystem crisis can only be a diverse management team, which includes not only diverse personal characteristics but also *“diversity in the areas of academic degrees, gender, age, and origin”* (VC employee 01).

4.2.3 Factor 3: Value Identification of Competitor Landscape

It is certain that the market will become much more polarized than previously throughout the screening process. In recent years it has been a narrative of "haves and have-nots" (VC employee 04). Due to the fact, that money concentrated in relatively few enterprises - they widely talked about "flight to quality" (VC employee 02). This pattern will continue in the future, with the "best" enterprises getting the greater share of new cash. One reason for this is that in a declining market, big corporations will have the option to acquire weaker rivals, contributing to industry consolidation (Business angel 02). As a result, analyzing competitive advantages must go a step further; VCs must seek for unique sustainable advantages in start-ups where they perceive promise (Venture builder 01). The VC's particular competencies should complement the startup's vision and values, accelerating synergistic effects and knowledge spillovers. Therefore, in future the analysis of competitors will be examined even more meticulously and purposefully, and *“outsight experts should be consulted even more often”* (Business Angel 02).

4.2.4 Factor 4: Corresponding Disruptions and Product Evaluation

As stated by the respondents, *“analysis of a product should be conducted from two different perspectives* (VC employee 03). Despite the fact, that the business case of the product and the strengths of the start-up both need to be examined more closely, especially for possible new targets, the crisis in the venture capital ecosystem is likely to last for some time, which shows

that venture capital funds also need to take a closer look at the portfolio companies they have already acquired (Business angel 01). It shows that crises encourage disruptive inventions, which then cause some patterns to alter or be resurrected. The identified trends for the respondents, raised through the macroeconomic landscape, are *“energy and the environment at the centre of debates”*, which includes technology that might assist the transition to a sustainable energy source and mitigate the effects of climate change (VC employee 01). It is highlighted as one of the most important prerequisites and characteristics to have the capability of understanding trends and the impact of products on a company's operations (VC employee 04). This enables VCs to understand the information and innovations that can be provided by companies that are part of an ecosystem.

4.3 Emerging Strategies for VC business and portfolios

The interviewees see many implications for the continuation of VC portfolios based on the macroeconomic developments outlined above and the anticipation that the long-term perspective is a prolonged crisis. This belief is based on the *“expectation that the long-term perspective will may worse than we expect”* (Venture builder 02). In addition, the validation of a successful strategy that can be implemented over the long term is contingent on the four aspects that surround the screening process. *“Rather of acquiring new assets, more capital is used to maintain and enhance the needs of the current portfolio”* (VC employee 03). It is described that insider rounds have been considered as a sign of strength by investors prepared to put more money into successful corporations in recent years as they aim to concentrate on winning companies. Expecting a shift away from the current trend, which calls for insider rounds to be used largely to assist cash-strapped portfolio businesses (Business angel 01). Moreover, venture capital firms must start the process of expanding their role as a platform for the portfolio companies. According to the interviewers, the objective is to discover synergistic

methods for the organizations to collaborate (VC employee 02). Moreover, venture builders are becoming an *“increasingly important component of seed businesses as a supporting element”* (Venture builder 02). The significance of human capital as the fundamental factor is emphasized once again. *“Even when there are many layoffs, competition for smart talents persists”* (Business angel 01). Since the disruption produced by Covid, the possibility of hybrid workforces has been brought up, *“and it is a fascinating variable to examine”* (VC employee 04). Due to this, it is now possible to recruit from a global talent pool. In this sense, venture capitalists must evaluate which skills are also evolving as hybrids and how to organize all of this within the broader framework. Since there are fewer exits on the market, venture capitalists must build possibilities, discover distinctive assets, and promote them through extending runways. In addition, they must give more guidance for the companies in their portfolios. The emergence is described as *“a fundamental re-screening of the organization since it went through the venture selection process”* (VC employee 02).

5. Discussion and Conclusion

The last part of this thesis adds to the overall objective of answering the research question by comparing the literature-based perspectives of academics with the data analysis results. In addition, this part will discuss the implications for practitioners, the limits of the study, and future research directions.

5.1 Discussion and Findings

The present review will discuss three fundamental concepts. Firstly, the empirical findings are consistent with the literature and recent research focusing on the financial and organisational problems of the VC ecosystem, thereby focusing on the challenges and arising opportunities. In general, academics have conducted research and studies on the subject of how the influence

of public markets and therewith the increase in interest rates has had an effect on venture capital (Monika & Sharma, 2015b; Zider, 1998). However, on one hand, it is impossible to compare the opinions of writers who have researched earlier crises. This is because the venture capital ecosystem reached its apex in 2021, and as a result, precedents cannot be utilised (The Case for Venture Capital in 2022 and Beyond, 2022). On the other hand, the research and surveys that deal with the events that have occurred over the course of the previous twelve months are vague when it comes to empirically detailing which activities should be undertaken by various functions (Gompers et al., 2008; Milosevic, 2018). The paper extends the theoretical research and offers empirical insights on how certain aspects of the deal flow that are involved in the screening process altered as a result of the ecosystem crisis. Besides the economic situation, if one compares the previous research papers with the studies and the expert interviews, it becomes clear that the technological advances have clearly minimized many classical agency-principal problems (Mason, 2009). Through Covid 19 we have managed to avoid digital information asymmetries. This is also now showing to be a factor in reflecting the current situation (Klonowski, 2022). As described by VC employee 01, the technological requirements give the possibility to act between the portfolio companies and to achieve complementary synergy effects through good communication. A point that was mentioned by (Dushnitsky & Lenox, 2006; Zarutskie, 2010) but also by various respondents is the factor human capital in times of crisis. Venture builder 02 mentioned how important it is that the founder/CEO is a good crisis manager (Miloud et al., 2012). confirmed from previous studies that heterogeneous management is the key to success. Furthermore, the firm dynamics are shaped by diverse and educational experienced entrepreneurs and leaders (Queiró, 2022). Contrary to the assumptions from the studies, **the first hypothesis can be rejected.**

Business angel 02 describes, the fast profitability becomes an important factor, but this also means that there are enablers who recognize this shift of the quantitative consideration in

the assessment. Thus, it becomes even more important for venture capitalists to promote the right composition of management teams with a diverse skillset. Studies as well as respondents indicated that the overall market situation is not considered good. However, the interviewees confirmed (Business angel 01) that more deals are currently happening in the seed funding area. Especially due to the news, that Unicorns are losing a lot of valuation (Gorilla), the market in the later-stage segment is very inactive and funds as well as entrepreneurs are trying to get by without asking for or giving out capital. **Therefore, the second and the third hypothesis cannot be rejected.**

From the further results, opportunities for VC fund operations in the near future can be identified. The technological possibilities give the chance not only to reduce information asymmetries but also to work on qualitative topics with the entrepreneurial team outside of the supervisory board and other quarterly meetings. The main focus is to implement the information that VC funds have through the screening process such as market insights and competitor landscape in the past-investment process. Furthermore, the VC firms should rescreen their current portfolio companies due to the completely new market situation. The market is a completely new one and it will be imminently important to find out which industries exist and thus get the existing funding. Thereby, this crisis will again bring with it innovative disruptions. At Covid 19, it was information technology and the healthcare sector, while it currently looks as if the market will be dominated by topics in the field of energy supply and sustainability (Business Angel 01). The literature from the past, the currently published studies regarding the market sentiment and the qualitative interviews show that the selection process in the decision-making process for VC companies is one of the most important qualitative considerations from which all other factors are influenced holistically and sustainably.

5.2 Practical Implications and Contribution of the Research

The results of the study contribute to existing research by providing an overview and advice to multiple players in the venture capital ecosystem. For limited partners investing in funds, venture builders working in close cooperation with funds, business angels and finally for venture capital funds themselves to understand which factors are imminently important to better evaluate targets for the future and to restructure already acquired portfolio companies. In detail, the establishment of the newly weighted factors in the assessment process can be used to find suitable targets that achieve a sustainable valuation and develop successfully in this respect. Furthermore, this study offers VC funds the opportunity to recognize more precisely that qualitative factors such as the right skillset of entrepreneurs are still absolute push factors to have a competitive advantage. Next, it offers the possibility to find out which appropriate strategies regarding emerging ecosystems are beneficial for the next crisis. Finally, the results of the study can be used by companies to consider how venture capital funds need to change in order to support the entrepreneurial landscape not only as fundraisers.

5.3 Limitations and Further Research

The paper provides data from eight different in-depth interviews with three different ecosystem actors (venture builders, venture capital funds and business angels) from eight different companies and highlights limitations and future research directions. First, the interviewees were selected based on personal relationships (e.g., they are all from Germany). In addition, each interviewee represents a specific industry and company size. Two other limitations emerged. The sample size and the lack of diversity in the sample. Further studies could expand the number of respondents and examine trends and adjustment across industries, jobs, and firms. Second, the data were manually coded by a single person, which increases the likelihood of errors, incorrect codes, and misinterpretation. Third, the study focuses only on the macro

economical implication of the screening process and therewith the qualitative factors surrounding the assessment. However, a more detailed examination based on specific responsibilities in an ecosystem, in addition to those listed, and an examination of entrepreneurial roles related to organizational duration and position could complicate the observations. Involving additional stakeholders, such as C-level entrepreneurs and Partners of funds, who are accountable and responsible for employing the required roles and skill sets, might also add depth to the study. In addition, a quantitative survey and company- or role-based case study might lend impartiality and precision to the results. Due to the relatively recent innovations and emergence of VC subjects relating to financial crisis responses, the complete and in-depth literature on ecosystems is restricted. Consequently, future studies might statistically examine the annual financials once they are published. Consequently, more empirical research might compare VC funds and concentrate on the entrepreneurial and human capital abilities that are most relevant to portfolio businesses.

6. Conclusion

To summarize, based on the research question “*How should Venture Capitalists adapt their screening methods to overcome challenges and capitalize on opportunities*”, the findings outlined three 3 factors that are important to survive in the new VC ecosystem. First, they need to rethink the process by incorporating qualitative and quantitative factors, with the human factor still cited as the biggest success factor. Second, portfolio companies need to be promoted and through the screening process there is the possibility to identify new potentials. Third, VCs need to look for new industries through market disruption because the other factors, such as market potential and product, continue to enjoy a high weight in the assessment process. This study discussed the changes and adaptations of VC methodologies, towards emerging ecosystems. However, activities and responsibilities cannot be fully differentiated and need to be generalized. Focusing on the research aim three hypotheses have emerged whereby two could be confirmed by the expert interviews. VCs and ecosystems are in transition. Growth and market potential are viewed differently. Instead, the focus is on sustainable growth with the achievement of rapid positive cash flows and profitability. An opportunity for decision makers will be to take pre- and post-investment action with the new factor scores validated by the thesis.

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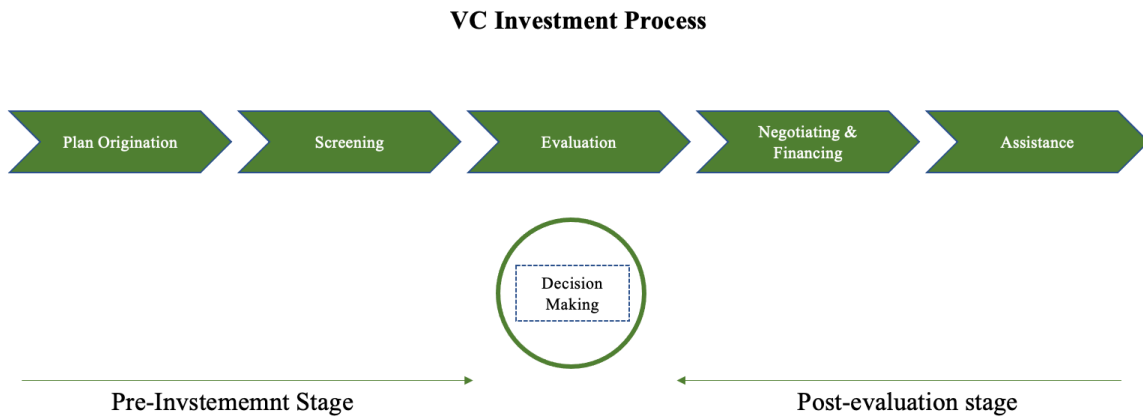
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APPENDIX

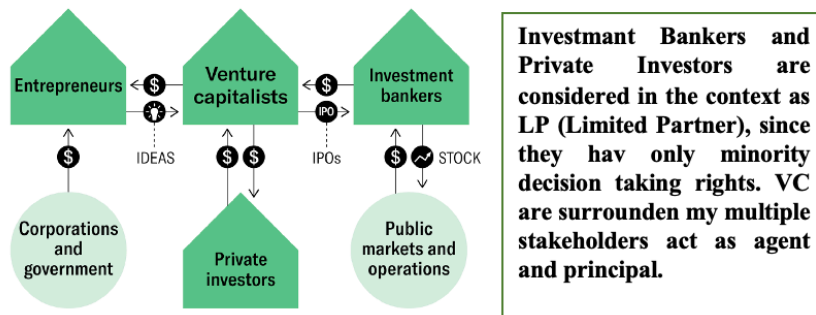
Appendix A: The Venture Capital INVESTMENT PROCESS



(Source: own illustration based on Tyebjee & Bruno ,1984)

Appendix B: How The Venture Capital Industry Works

VC Ecosystems



(Source: Zider, 1998)

Appendix C: Overview of People Interviewed

Organization	Type	Position	Code
TruVenturo GmbH	Venture Capital	Analyst	VC employee 01
Digital + Partners	Venture Capital	Analyst	VC employee 02
N/A*	Venture Capital	Advisor	VC employee 03
Project A	Venture Capital	Analyst	VC employee 04
N/A*	Business Angel	Self Employed	Business angel 01
N/A*	Business Angel	Founder	Business angel 02
BCG X	Venture Builder	Senior Growth Architect	Venture builder 01
Flow Partners	Venture Builder	Founder	Venture builder 02

*Interview partners wanted to stay anonymous and not be linked to their respondents

(Source: own illustration)

Appendix D: Interviewee Questionnaire

Executive Interview Guide –Master Thesis Nova SBE– Kelvin Hackmann

About the Interviewee	
Name:	_____
Company:	_____
<input type="checkbox"/>	Business Angel
<input type="checkbox"/>	Venture Builder
<input type="checkbox"/>	Venture Capital
<u>This information will not be published and is just for a personal overview</u>	

Theme	Question
Introduction	<p>In that interview, I want to get a deeper understanding of how venture capital company behavior has altered considering recent ecosystem changes.</p> <p>I attempt to comprehend and investigate how Venture Capital organizations modify their screening procedures and evaluations. The investigation will also consider how the role of venture capital firms is seen, experienced, and evolving within the ecosystem.</p> <p>This interview will run between 30 and 45 minutes, and there are no correct or incorrect responses. As the interview will be semi-structured, each participant will also be asked questions based on their responses and opinions. Therefore, questions may differ somewhat across interviews.</p>
Recording	Can I record the interview for the purpose of analysis and transcribing?
General & Background Information	<ol style="list-style-type: none"> Can you tell me what your current role is and how long you've been doing it? <ul style="list-style-type: none"> Have you worked in this job role at a different company beforehand? What is your reporting line to the CEO/Partner? How would you define your own role? <ul style="list-style-type: none"> What responsibilities do you have? Which skills (soft/hard) do you consider most important to work in your role?

Market environment	<p>3. What is the biggest challenge, you currently see for venture capital business?</p> <p>4. Is it the end of the race for Venture Capitalist to deploy as fast as possible?</p> <ul style="list-style-type: none"> ○ Are there any trends in the funding environment you already noticed? <p>5. What is the most promising sector/industries for VC investments in the future?</p> <ul style="list-style-type: none"> ○ What are the challenges for those companies from a financial point of view? <p>6. How confident are you in the long-term growth prospects of the Venture Capital industry in your market?</p> <ul style="list-style-type: none"> ○ Are there differences between the stages of start-ups? <p>7. What role(s) (if any) should governmental and European bodies play providing capital to VC's and start-ups?</p>
VC Screening Process	<p>8. How does your company changed their analysis approach when assessing the market and possible acquisition targets?</p> <ul style="list-style-type: none"> ○ What qualitative techniques are used? <p>9. What factors become more relevant or are weighted differently?</p> <ul style="list-style-type: none"> ○ Do funds concentrate more on quantitative factors (e.g., positive Cash flow)? <p>10. Which skills, education, HR management, resources are required by entrepreneurs in order to strive for a company's success within an ecosystem?</p> <ul style="list-style-type: none"> ○ What skillset would you rate to be the most important in the future? <p>11. Based on the previous questions and answers, how do the role of Venture Capital businesses need to adapt in your perspective?</p> <p>12. How do you see your company/industry in the ecosystem perspective?</p> <ul style="list-style-type: none"> ○ Do you have the right roles, setting and responsibilities for that? <p>13. What is required by companies and actors?</p> <p>14. What are success factors four you to cope with the emerging ecosystems?</p>
Closing	<p>15. Do you want to add something else, that I have not touched yet in the interview?</p>

Appendix E: Interviewee Questionnaire

Excerpt from Coding - Theme 2: Factors Required for VC Pre-Investment Process

Resp	Excerpts from the interview	Codes	Categories
VC employee 04	- "valuations detached from actual values and increasingly concerned with what potential could be achieved with total market dominance" - "More interested in Cash Flow of own Portfolio companies"	- Financial - Quantitative - Profitability - Crisis	Market potential and quantitative considerations
VC employee 01	- "classic business models and already established market players were ignored as long as the potential of the market was significantly high with the purpose of becoming the new Uber or Airbnb in the end" - "Instead of market potentials we are focussing on Early Profitability Drivers e.g. (Cash/Conversion Cycle)"	- Cash flow - Burn rate - Interest rates - Increased values	
Venture builder 02	- "You can feel that everyone in the market is more sensitive to money because they realise that the crisis could last longer than first thought"		
Venture builder 01	- "Human capital is the most important start-up success factor" - "A management team needs to a lot of experience during the crisis and a diverse set of skills"	- Human capital - Skillset - Qualitative factors - Entrepreneur	Skillset and Management
VC employee 03	- "in a good market environment, a lot of entrepreneurs and good ideas will have success and achieve high valuations"	- Diverse - Heterogenous - Management team	
Venture builder 02	- "decisive, goal-driven, flexible an excellent communicator and cool-headed excellent listener" - "Anticipation of crisis events will be better with more education" - "Communication is key to succeeding and more important than technological skills in a crisis"	- Crisis manager - Technological skillset	
VC employee 01	- "diversity in the areas of academic degrees, gender, age, and origin will more likely lead to creative solutions and different views, accelerating changes"		

Resp	Excerpts from the interview	Codes	Categories
VC employee 04	- "Screening will polarise the market. In previous years, "haves and have-nots" dominated"	- Competitive advantage - Portfolio - Consolidation - Monitoring Value	Competitor Landscape
VC employee 02	- "flight to quality and therewith consolidation is more likely than expansion therewith we monitor our competitors in depth" - "Competitive advantages are not longer existing, sustainable competitive advantages are the goal to reach not like Gorillas, Revolut, Klarna...."	- New opportunities and possibilities for innovation	
Venture builder 02	- "that in a declining market, big corporations will have the option to acquire weaker rivals, contributing to industry consolidation"		
VC employee 03	- "Despite the fact, that the business case of the product and the strengths of the start-up both need to be examined more closely"	- Disruption - Innovation - Quantitative measures - Trends	Disruption and Product Evaluation
VC employee 01	- "energy and the environment" which includes technologies that might help shift to a sustainable energy source and prevent climate change will be the upcoming trends"	- Macroeconomic - Sustainability - Technology - Portfolio	