The Development of Trust in Venture Capital-Financing Relationships

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$$w\Delta z = Cov(w,z) = \beta wz\ Vz$$ [1]

It's all in the numbers: selfishness and treachery are in the genes.

[1] Version of the Selfish Gene Theory equation by George Price (cira. 1960)

Abstract

Venture capital-financing in New Zealand, still in its relative infancy, will come to play an increasingly important role in the economic growth of this country. Of the very limited research conducted in this area in New Zealand, the focus has been on hard data of numbers of ventures and dollars invested. Of growing interest in other industrialised markets, across all business disciplines including venture capital-financing, is the facilitative role of trust in contributing toward successful commercial outcomes. Using a qualitative approach, this thesis applies current knowledge of trust in venture capital-financing relationships to the New Zealand context and combines both survey and interview data collection methods. An adaptation of the grounded theory method is used to analyse the results. Arising from this analysis is the construction of a model illustrating the development of trust within venture capital-financing relationships. Comprehension of the model and overall research findings employs the explanatory power of a five-pillar theoretical construct of trust development comprised of agency theory, prisoner's dilemma theory, social exchange theory, procedural justice theory and interpersonal trust theory. This thesis concludes that ultimately, venture capitalists have greater control over ventures than entrepreneurs, and also that venture capital-financing relationships in New Zealand generally lack a strategic approach to the development of trust. Further, failure by venture capitalists and entrepreneurs to proactively develop trust renders their relationships prone to destruction, as predicted by existing theoretical precepts.

For Mum and Dad

Acknowledgements

My gratitude goes to the participants in this research for giving up their time and sharing their insights. I wish also to thank Mina for his valued input, my supervisor Coral Ingley and Massey University staff, and of course Mars for being so amazingly supportive over the last two years.

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[2] Note that most of the tables correspond with questions in the VC and entrepreneur questionnaires, represented by the question number. (e.g. Q.EC3 – entrepreneur questionnaire, section C, question 3)

Introduction

This Thesis broadly examines the venture capital financing model used in New Zealand and the development of trust in relationships between venture capitalists (VCs) and entrepreneurs. The first three sections of this project are assembled in the following manner. Firstly, background information relating to the venture capital model, entrepreneur/VC relationships and trust is presented. The next section defines the problem and outlines research objectives. This involves identifying existing trust-related theory previously used to explain the relationships between entrepreneurs and VCs. Finally, the methodology used in this research and the structure of the project are introduced.

Background

Wealth creation in New Zealand is expected to come from the continued development of small, entrepreneurial firms which populate the local commercial sector. This is a view consistent with the opinion that small and medium-sized, entrepreneurial firms will come to dominate the global economy (Cameron & Massey, 1999). In accordance with this contention, innovation and entrepreneurship are required for New Zealand's future international competitiveness and economic growth. Highlighting the importance of entrepreneurs in New Zealand's economic future, Timmons (1990, p.13) claims, "The entrepreneurial role has long been recognised as a prime source of innovation and creativity."

A growing contribution to the development of entrepreneurial and innovative firms in New Zealand is from the venture capital sector (Gawith, Morgan, Grimmond, 2000; Balls, 2001). Supporting this view is commentary from the New Zealand Venture Capital Association (NZVCA) (2002). In light of this country's comparatively regressive economic standing internationally, (Cameron & Massey, 1999; Eagles, 2002) the success or otherwise of small and medium-sized enterprises (SMEs) over coming years would appear to have ramifications for every New Zealander in terms of their overall economic contribution to New Zealand's standard of living (Markman, Balkin & Schjoedt, 2001).

The model of venture capital-financing recognisable in New Zealand bares much likeness to that found in other countries. Generally speaking, this model is recognisable by its various distinguishing attributes uncommon to other forms of financing. These model attributes, particularly the imperative for collaboration and cooperation, influence the relationship between entrepreneurs and VCs. Accordingly, these relationships, to a large degree, are distinguishable from other forms of business relationships.

By examining and analysing venture capital-financing relationships, an understanding is gained of the factors, and their interplay, that contribute to venture success. One of these factors is trust. The orthodox premise in relation to trust is that the greater the trust between the entrepreneur and VC the more effective the working relationship and therefore prospects of a successful business outcome; when trust between the parties is retarded the opposite is true. The proposition relied upon is that high levels of trust in any relationship provides a superior basis for interaction (Zand, 1972). This is particularly so if trust is such that the requirement for restrictive monitoring and control mechanisms (McAllister, 1995; Cable and Shane, 1997) such as documentary reporting, personal performance assessments, underperformance penalties, mechanistic organisational structures, high level formal contracts and covenants is reduced or unnecessary altogether (Pugh & Hickson, 1995).

Drawing on the disciplines of sociology, psychology and behavioural science (Tyebjee & Bruno, 1984), trust has commonly been a looking glass through which these relationships have been explored (Shepherd & Zacharakis, 2001; Harrison, Dibben & Mason, 1997). While trust in venture capital-financing relationships has been the basis of previous inquiry, more often than not it has been a periphery issue, or a mere component of wider theoretical dimensions (Cable & Shane, 1997), such as in the area of co-operation theory (Faulkner & De Rond, 2000). An assumption of this thesis is that as the relational dynamic between the entrepreneur and VC is distinctive, because of venture capital model attributes, so too will the interaction of trust be distinctive. A wide breadth of theory has typically been applied to the examination of trust in relationships, including in the venture capital context (Cable & Shane, 1997; Sapienza & Gupta, 1994). Other studies (Shepherd & Zacharakis, 2001; Sapienza, Korsgaard, Goulet & Hoogendam, 2000; Sweeting & Wong, 1997; Busentiz & Barney, 1997; Fredriksen & Klofsten, 2001) have sought to explore this field, but without identifying an appropriate trust construct. This study takes the issue of trust out of other empirical and theoretical contexts and places it in the specific context of the entrepreneur/VC relationship. "Context is everything when it comes to trust" (Ward & Smith, 2003, p.16).

Problem Definition and Research Objectives

A growing body of literature explores the relationships between entrepreneurs and VCs. This is due to the increasing importance of venture capital to economic growth. Research in this field to-date has grappled with the distinctive nature of venture capital relationships seeking understanding and explanation of the antecedents to venture success. However, what is apparent in recent writing in connection with collaborative business relationships, and more particularly venture capital-financing relationships, is that there is a shift in focus away from transaction cost economics and hierarchical explanations of relational interaction, toward the relevance of social and interpersonal dynamics.

In the venture capital context, the relationship during the post-investment phase is one of collaboration (Tyebjee & Bruno, 1984). This has encouraged extensive literary debate on trust, a recognised intrinsic foundation of all interpersonal relationships, into the specific arena of venture capital-financing relationships. This debate was long overdue and its recent emergence highlights the traditional dominance in business literature of theoretical economic doctrine (Faulkner & De Rond, 2000; Harrison, Dibben & Mason, 1997). But this traditional doctrine has now given way to the contemporary realisation that trust is a vital component of effective business relationships (De Clercq & Sapienza, 2001; Shepherd & Zacharakis, 2001; Herzog, 2001; Costa, Roe & Taillieu, 2001; Ward & Smith, 2003; Larson, 1992; Zand, 1972).

Business research vis-à-vis trust, initially focused on strategic alliances or essentially inter-firm relationships. Game theory especially contributes to this area of research (Schumacher, 2001). This presented the opportunity for researchers to observe relationships set within an entirely different context of interaction compared with more traditional inner and intra-firm relationships. Venture capital-financing relationships, on the other hand, are hybrid arrangements which are both strategic alliances and political constructs commonly thought to resemble principal-agent forms of interaction (Cable & Shane, 1997). This is realised by venture capitalists occupying the role of both an outsider, whilst still interacting in the political fabric of the firm being financed.

Co-operative paradigms of interaction have become a predominant framework for understanding venture capital-financing relationships, challenging traditional agency analysis in attempting to model these relationships (Cable & Shane, 1997). Notwithstanding, trust has largely assumed a secondary role in this mainstream field of research.

A problem with existing research approaches is apparent in the literature. Despite substantial efforts in attempting to explain how trust is formed in these relationships, trust-related theory and analysis has been largely omitted from the venture capital-financing model itself. There are three reasons for this. Firstly, there is a pre-occupation in the literature with simply trying to develop concise application of trust-related theory to business relationships or organisational behaviour in general (Costa, 2000) and not specifically in relation to venture capital financing (De Clercq & Sapienza, 2001). Secondly, there are difficulties in reaching consensus of agreement on such matters as causations and even definitions alone, which has proved problematic (Mayer, Davis & Schoorman, 1995; Butler, 1991). For instance, the concept of trust has yet to produce a universally agreed definition and understanding (see Rousseau, Sitkin, Burt, & Camerer, 1998 for cross-disciplinary summary). And finally, inquiry into the fields of sociology and psychology are fraught with complexity which makes understanding and explanation of trust very difficult. (Armstrong & Priola, 2001; Devine, 1999).

The venture capital model, defined later, impacts upon the development of trust in venture capital relationships. Previous theoretical development does not take full account of the distinguishing features of venture capital-financing arrangements, particularly in terms of formal structures such as contractual terms and governance, and non-financial contribution (Sapienza, Manigart & Vermeir, 1996) in trying to explain trust. Even approaching the issue in terms of co-operative imperatives, typically, discussion fails to consider limitations to co-operative behaviours, imposed by model constraints (Shepherd & Zacharakis, 2001; Faulkner & De Rond, 2000). Instead, the propensity has been to argue the merit of various trust-related theories for increasing trust, without full consideration of the factors which promote or inhibit trust creation under these circumstances.

To achieve the goals of this research, parameters to current trust literature need to be established due to existing research in this area being particularly broad and confusing. The dimensions of trust that are applicable to cooperative relationships need clarification. Once this is achieved the attributes of the New Zealand venture capital-financing model can be examined for elements that engender and/or erode trust in the entrepreneur/VC relationship.

The **first** objective in this thesis is to describe the model of venture capital-financing commonly observed in New Zealand. The model establishes the expectations of each party to venture capital relationships and standard rules to formal agreements. The **second** objective of this thesis is to establish an appropriate theoretical framework or construct of trust, to use as a tool for the assessment of trust development in venture capital-financing relationships. This construct is to be derived from extant theory, and established by thoroughly reviewing trust-related literature. This framework may prove useful to future venture capital-financing and trust-based research for several reasons. Firstly, the development of the trust framework will provide an effective, practical tool for assessing trust in venture capital relationships. Secondly, in using this framework, research into the field of trust in business relationships may lead to a solution-based ethos, seeking practical answers to practical problems. The **third** and final thesis objective is to construct a model which charts the development of trust in venture capital-financing relationships. This is achieved via a combination of theoretical analysis and empirical investigation.

Structure of the Project

This thesis is divided into four parts. **Part I** achieves the first two research objectives. Firstly, the venture capital-financing model found in New Zealand is explained, prior to an investigation of cooperative relationships and review of the literature on trust. Further analysis is undertaken to identify theoretical propositions relevant to both understanding the dimensions of trust for data collection purposes and explaining the actual manifestation of trust in venture capital-financing relationships. Creation of a trust development construct in this section satisfies the second research objective. **Part II** outlines the research process of data collection and analysis using an adaptation of the grounded theory method (Strauss & Corbin, 1990). Methods of data collection include a mail survey and interviews. The research results are presented in **Part III**. **Part IV** concludes by presenting a model of the development of trust in New Zealand venture capital-financing relationships, accompanied by an extensive explanation that combines empirical observations and theory. Research limitations and a direction for future research are examined before presentation of the thesis conclusions.

PART I:

1. Theoretical Framework

1.1 The Venture Capital Financing Model

This chapter describes and analyses the venture capital-financing model prevalent in New Zealand. This model possesses attributes which constrain and promote trust within the relationship between entrepreneurs and VCs. To this end the structures, systems and processes which comprise the model need to be identified. Entrepreneur/VC relationships have been the subject of extensive inquiry, particularly in terms of attempting to explain the determinants of such relationships. More recently, trust has assumed recognition in the literature as important for explaining interaction in these relationships. Section 1.1.1 commences this chapter by defining venture capital, a necessary prelude to describing the venture capital model in section 1.1.2. Finally, a definition of venture companies, otherwise described as firms in receipt of venture capital, is provided.

1.1.1 Venture Capital

Venture capital-financing is a form of strategic alliance. This Das & Teng define as, "inter-firm cooperative arrangements aimed at achieving the strategic objectives of the partners" (1998, p.491). Venture capital-financing describes minority-equity alliances between VCs and venture companies. The term "venture capital" is an abstract creation. Capital does not *become* venture capital until utilised for a specific purpose, and its use guided by generally recognised rules. Therefore, in reality, there is no such thing as venture capital; only capital that is defined by the projects or ventures to which it is committed for use. Gawith et al. (2000) argue that effectively all equity capital is venture capital in one form or another and that investment risk is often a delineating factor. The product of high risk, being business failure, therefore also serves to differentiate venture capital from other forms of investment capital. This is noted by Gorman & Sahlman who state that "failure is at the very least endemic to the venture capital process" (1989, p.238).

If a specific end-use of capital so defines it as venture capital, then it becomes necessary to further understand the ingredients of this usage. To this end, two points of reference are needed. The first considers the purpose of venture capital and the second consists of the set of rules, conventions and structures applied to financing agreements. Both reference points are common to all venture capital financing arrangements, but can consist of venture-specific conditions and attributes. The latter rules, conventions and structures effectively compose the financing model of distinct relevance to this study. These aspects are expanded upon later.

Broadly speaking, venture capital is applied to ventures with a view to rapidly accelerating growth (Sahlman, 1994) when a market opportunity presents itself. Shepherd & Zacharakis suggest venture capital is directed toward "high potential" firms that are "relatively established" (2001, p.140). Potential in this context could be regarded as growth prospects, which inevitably implies expectations of accelerated financial return. Steier & Greenwood take a slightly different perspective, instead defining venture capital from the perspective of inputs stating, "venture capital represents an active form of financing in that VCs strive to add value, beyond capital, to their investments" (1995, p.339). From an economic standpoint, information asymmetry (Gawith et al., 2000) and investment illiquidity (Tyebjee & Bruno, 1984) are additional elements defining venture capital.

Gawith et al. (2000) value the New Zealand venture capital market at two billion dollars, representing only two percent of all unlisted equity investment. The economy of New Zealand is comparatively small, with historically limited opportunity for initial public offerings (IPOs), management buy-outs (MBOs) and trade sales, all typical VC investment exit strategies, another feature of venture capital-financing. This is largely due to a relatively conservative public appetite for stock market investments and the strong preference of local managed funds to spread investments into offshore equity markets (Knuckey, S., Johnston, H., Campbell-Hunt, C., Carlaw, K., Corbett, L., & Massey, C.). Furthermore, the capitalisation required to make public listing attractive is prohibitive, particularly for smaller firms wanting to jump the threshold in size to become larger. Aside from limited IPO opportunities, the size of the corporate investment sector in New Zealand also limits equity availability for acquisitions, mergers and buyouts.

The term of venture capital investments in New Zealand can range from approximately three to seven years or longer. The timing of investment is generally post "start-up", though private equity investors often seek earlier stage opportunities. Investment typically occurs at the time of penultimate rapid firm growth and market development in well-established, medium-sized firms (Gawith et al., 2000; NZ Venture Capital Monitor, 2002). The entry point of investment is an important aspect in classifying venture capital, if only in terms of the intended outcomes following alliance formation and prospects for growth for any given enterprise. Some confusion seems to exist among New Zealand venture capital industry participants about this entry point. However, the requisite aims of rapid growth, high risk/payoff and so forth, can apply to various stages of the firm lifecycle where capital is injected to achieve such goals. Therefore, it seems investment entry timing becomes largely academic, and not necessarily a practical indicator by which to define venture capital. Timing is only relevant to opportunity for rapid market and firm growth, and this may occur at any time along a given firm or industry lifecycle (Greiner, 1998).

The purpose of venture capital is to grow the market value of an enterprise rapidly, with a view to reaping a significant capital gain upon exit. A requisite for attracting venture capital in the first instance is rapid growth prospects for a given enterprise. Although there exists diversity of opinion regarding an industry definition of rapid growth, Sahlman (1994), citing American standards, stipulates a requirement of 30 to 50 percent return on investment to qualify. One NZ VC[3], for example, reports an internal rate of return (IRR) of 44 percent across 13 divestments over the period 1995 – 98.

Typically, such growth prospects are apparent in firms with highly innovative technologies (Tyebjee & Bruno, 1984). Hence venture capital is most commonly directed toward high-tech, cutting edge and green field industries and enterprises[4]. Zider (1998) asserts the position that VCs only invest in high-growth industries and that this is the over-riding investment decision criterion. This appears to not necessarily be a defining criterion in New Zealand where risk aversion is moderate to high.

In summary, venture capital investments are typically recognised by the following criteria.

- Clear intention of VC exit in the medium term (approximately 3 – 7 yrs).

[3] Direct Capital Private Equity newsletter 2003
[4] new enterprises in new industries

- Investor expectations of rapid venture growth, with a view to significant capital gain. This impacts upon investment entry timing. (expected returns in New Zealand of between 25 and 40 percent and upwards) (Gawith et al., 2000).
- Preference for investing in industries and firms with high-tech, innovative products and services.

And as will be examined in the next section:

- Collaborative relationship between VCs and venture companies. "Hands-on" contribution to ventures by VCs over and above just cash.
- Conjoint ownership of venture between VC and entrepreneur (and often other investors)

1.1.2 The Venture Capital Model

Venture capital relationships, like other cooperative relationships have rules and conventions which govern their operation. These rules and conventions make up what is termed the venture capital-financing model. The rules and conventions which define the model have a twofold purpose. Firstly, they signal the intentions of the various actors and set out the expected returns from the investment. Secondly, they limit risks and transaction costs of the investment by determining what the alliance partners must and/or must not do.

Examples of these rules and conventions include: (a) equity sharing between the VC and venture company (Steier & Greenwood, 1995); (b) the VC routinely assuming a directorship on the venture company's board (or at least appointing a non-executive director); (c) developing various rules of engagement that seek to protect parties from opportunistic actions by each other (Sweeting and Wong, 2000); and (d) establishing performance objectives (Tyebjee & Bruno, 1984).

In addition to these mechanisms, other forms of contribution are generally expected of each party to support the venture. Contributions rely upon the premise of knowledge specificity (Cable & Shane, 1997), where each party to a venture can contribute specialist knowledge, thereby exploiting individual comparative advantage. For example, the venture company will logically contribute their industry and technological knowledge and the VC usually contributes strategic operational support, access to networks, and mentorship. Finally, Macmillan, Kulow & Khoylian (1989) include management selection, personnel management and financial participation as additional VC contributions to their ventures. Tyebjee & Bruno (1984) list VC post-investment activities as setting up controls to protect the investment, providing consultation to management, and helping arrange exit strategies in the form of mergers, IPOs, etc. A vital component of the venture capital model is the investment agreement between the entrepreneur and VC. This, Fried & Hisrich (1995) would conclude constitutes the VC's formal power. Tyebjee & Bruno (1984) cite several typical ingredients of these agreements, including, the price of the deal, protective covenants restricting entrepreneur decision-making and actions, and the basis upon which the VC may take control of the venture company Board and replace its chief executive officer (CEO). These conventions further help to differentiate venture capital investments from other types of investments, and partially compensate for the high cost of money inherent to venture capital-financing (De Clercq & Sapienza, 2001). This compensation aspect may, however, be an inflated element of such cost in light of contemporary debate about the effectiveness of VC non-financial contribution (Sweeting and Wong, 2000; Macmillan et al., 1988; Barney, Busenitz, Fiet & Moesel, 1996).

Regardless of such debate, the value added to any fledgling entrepreneurial enterprise by a VC can be significant. After all, these alliances typically occur to exploit existing, identifiable entrepreneurial prowess and potential. However, finding balance between maximising value, reducing risk and protecting investments by way of governance provisions is an imperative of venture capital-financing alliances. Unsatisfactory venture performance is sometimes a product of destructive interpersonal relationships between the entrepreneur and the VC. The VC therefore has the delicate paradoxical task of balancing entrepreneurial freedom with formal power to maximise the venture company performance. Wright, Hoskisson, Busenitz, & Dial refer to "managerial perspectives of entrepreneurship" (2001, p.18) when explaining the scope of the task confronting VCs to ensure an adequate realisable return from their ventures. This view has to be considered in the light of the seemingly tenuous nature of venture capital-financing relationships, summated by Fried & Hisrich who state, "the VC can be either a constructive force, an impotent one, or even a destructive force in the company" (1995, p.102).

Of significant contention in the literature is the nature of the entrepreneur/VC relationship. The venture capital-financing model is central to this debate and comprises much of the theoretical discussion to follow. Two main perspectives prevail. These are that the relationship is either a strategic alliance of cooperation and trust, or equates to a principal-agent paradigm. Each is conditioned by the interaction of the entrepreneur and the VC, and may be venture specific, influenced by the negotiated formal agreement and contractual arrangements between them. Such agreements may consist of a number of conditions but effectively define the level of control that the VC expects to exert over the relationship. In addition however, a set of obligations and expectations of the VC is normally brought to the relationship. As discussed above, these consist of the VCs non-financial contributions to the venture.

1.1.3 Venture Companies

Venture companies, in the context of this research, are companies in receipt of venture capital finance. Although this research focuses on the interpersonal relationships between entrepreneurs and VCs, it is useful to illustrate the types of companies, and therefore environments, in which entrepreneurs operate to assist the current context building exercise. Summarising the literature, venture capital-financing is defined by the objectives of intended rapid and expansive venture growth and recognisable aspects of the relationship between the venture company (its entrepreneur/s) and the capital provider (VC) (Cuzens, 2001; Zider, 1998; Claridge, 2002; Fried & Hisrich, 1995). Although the definition can be simplified by being couched in terms of the financial relationship with the VC, a deeper analysis of firms eligible for, or receiving venture capital, reveals much more.

In some respects venture companies are metaphors for describing the characteristics of the entrepreneurs who often found and operate them. Gorman & Sahlman support this view, stating, "It may not be far from the truth to say that, to the venture capitalist, the entrepreneur *is* the company" (1989, p.241). These firms act as vehicles to realise the abilities and ambitions of the entrepreneurs behind them. Herein lays a significant explanation for the paradoxical entrepreneur/VC relationship, in terms of ambition incongruence. Simply, their underlying business objectives are not necessarily the same. Gorman & Sahlman (1989) elucidate an implicit contrast between the characteristics of entrepreneurs and VCs. They suggest the former pursues "the dream", and is motivated by wanting to see his/her company "live on" (1989, p.241). VCs, on the other hand are motivated by the desire to protect their investment and extract maximum value from their most precious commodity, time. The reason for this lies in the inherent differences in characteristics between entrepreneurs and VCs (Alsop, 2002; Gawith et al., 2000; Wright et al., 2001). Consequently, different characteristics produce different objectives and different emphases on business and interpersonal motivations, including trust. Whilst acknowledging the pertinence of individual traits upon interpersonal trust formation, this thesis excludes them from any later analysis. Inclusion of such analysis would add another layer of complexity to the study of trust in this instance, which lies outside the intention of a generic relationship modelling exercise only. Despite this decision the "entrepreneur" is profiled especially in section 1.2.2, principally for definition purposes and to further illustrate the nature of venture companies.

A significant factor which may differentiate firms obtaining venture capital from those that do not is the attitudes and personalities of their entrepreneur/s, already alluded to. This is particularly applicable to New Zealand companies in terms of growth prospects. Gawith et al. (2000) cite the New Zealand business culture as a restriction upon the desire for local entrepreneurs to develop their businesses beyond the size of the local market. Further, "Many [entrepreneurs] are hostile to the idea of having to relinquish some ownership in exchange for capital" (2000, p.10). Additionally, in New Zealand there appears a lack of entrepreneur willingness to tolerate the risk often associated with the pursuit of dramatic business growth. This often involves jumping the gap between operating a successful local company and building an internationally competitive entity. Gawith et al. refer to the stifling macroeconomic impact of "hobby businesses, rather than wealth creating enterprises" (2000. p.14). Wright et al. (2001) make a similar observation, referring to wealth preservation by successful business founders as reducing aspirations for growth.

Summarising venture companies, they are often characterised, not so much in terms of economic, structural and market-related dimensions, as by the entrepreneurs running them. Venture companies are defined as such by virtue of being in receipt of venture capital finance. These companies are inherently innovative and entrepreneurial, and usually found operating in high-tech, rapidly developing industries. Importantly, the personal interaction between entrepreneurs and VCs has significant relevance and consequences in terms of exploring trust and its implications for the venture capital-financing model.

1.2 Entrepreneurs and Venture Capitalists

1.2.1 Venture Capitalists

This research deliberately makes no material distinction between individual and organisational VCs. The venture capital-financing model prevalent in New Zealand is similar for both types of investor. Importantly, however, individual VCs are typically called private equity investors[5]. VC organisations in New Zealand are usually structured as special partnerships, though they may also be incorporated companies. The former is appealing to VCs for its favourable tax treatment. The internationally favoured organisational VC structure is the Delaware limited partnership model, currently being investigated for introduction into New Zealand. Typically, VC firms raise funds from autonomous investors which are commonly pooled together for investment allocation. It is not unusual for multiple VC organisations operating in this way to consolidate their separate funds into yet larger funds for investment purposes. The New Zealand Venture Investment Fund (VIF) (Gawith et al., 2000) is an example of such a fund. Alternatively, it is not unusual for different organisational VCs to act independently in financing the same ventures. Invariably new investments acquire *lead investors* who may source additional funding (*non-lead investors*) to finance a venture's start-up and/or growth strategy into the future. Sourcing additional capital is commonly considered to be one of the VC's key contributions to venture capital partnerships.

Companies in receipt of venture capital funding are usually appointed an investment manager by the *lead* VC. This individual is responsible for overseeing the investment and interacting with the entrepreneur and/or senior management team of the venture company. Using a

[5] By definition, the term private equity investor includes any individual whose investment activities fit the criteria of venture capital financing, as outlined in section 1.2 above. In some instances such investors are referred to as angel investors. Strictly speaking, private equity investors target earlier stage investments than organizational VCs. Their roles in terms of investment contributions and collaborative venture relationships discounts material distinctions for this research.

rationale similar to that of Macmillan et al. in their own study, "lead investing venture capitalists play more active roles in their portfolio companies…" (1989, p.28). Given the focus on interpersonal relationships in this research, it has been necessary to isolate this individual as distinct from broad reference to VC organisations.

Equally, private equity investors are invariably individuals who fulfil a similar role to that of investment managers. Not having organisational support however, these individuals would usually perform multiple functions, including venture company research, due diligence and hands on management of their investment.

VCs fulfil their roles according to the demands of the VC model already explained. Tyebjee and Bruno (1984) pioneered investigation into the investment activities of VCs, modelling these activities into a sequential five-step process. These steps consist of 1) deal origination, 2) screening, 3) evaluation, 4) structuring and 5) post investment activities. Only steps three to five are relevant for this study. In these phases interpersonal relationships, and therefore trust, are especially germane to the investment process. These latter steps manifest the venture capital model in which the entrepreneur finally engages and interacts with the VC. It is during the final stage of this process, when the "deal has been consummated, the role of the venture capitalist expands from investor to collaborator" (Tyebjee & Bruno, 1984, p.1054). In fact it is the period from steps three to five which is ultimately of relevance to this research.

In a study by Macmillan et al. (1989) it was discovered that of six of the most substantial involvement activities contributed by VCs to their entrepreneurs, the most important activity was that of a sounding board, or confidante (Gorman & Sahlman, 1989). Beyond task-related management support, the prominence of activities focused on *soft* or interpersonal collaboration and interaction between the entrepreneur and VC conveys the importance of relationship development in this dyad.

The activity reported as occupying the least involvement by VCs was strategic or operations functional areas. Research by Macmillan et al. (1989) claimed no statistical improvement in the performance of ventures with high levels of VC involvement which he refers to as "close trackers". This indicates that in fact high levels of operational contribution to ventures by VCs may offer little benefit and suggests that in areas where VCs cannot add value to their investments, they should probably stand clear. Confounding factors such as venture lifecycle position may however mitigate the reliability of the findings of Macmillan et al. (1989) (Fried & Hisrich, 1995).

1.2.2 The Entrepreneur

This section defines the entrepreneur. A definition is necessary for clarity in comprehending the overall topic and to provide balance in this discussion involving a dyadic relationship. The following brief review navigates a substantial body of literature relating to the entrepreneur.

Frustratingly, despite voluminous literature on the subject, there is no definitive explanation for either the entrepreneur (Johnson, 1990; Timmons, 1978) or entrepreneurship (Shaver & Scott, 1991). This observation may be the result of apparently wide inter-disciplinary parameters used in previous research (Gartner, 1989; Amit, Glosten & Muller, 1993) and topic complexity (Palmer, 1971).

In the minds of some writers, entrepreneurship, critical to understanding the entrepreneur, is a combination of thought and action (Timmons, 1978; Shaver & Scott, 1991). Action, over and beyond mere contemplation is inherent to the definition of the entrepreneur.
"Entrepreneurship is a process of becoming rather than a state of being" (Churchill, 1989,

p.21). In the present study, the problem of defining the entrepreneur is eliminated in the following way. A simple, yet logical assumption is made that if an individual is engaged in a financing relationship with a VC they *are* an entrepreneur.

A definitional criterion of entrepreneurs frequently mentioned in the literature is their apparent propensity to engage in disproportionately high-risk commercial activities. This presumed trait is however disputed by Brockhaus (1980), further reinforced by Palich and Bagby (1995). Despite these contradictory views, risk-taking propensity has a direct relationship with trust, and especially the influence of the risk-taking domain, as earlier implied (in this case the venture capital context). Hence risk-taking behaviours are relevant to this study.

Much research has sought to identify the commonalities among those who are deemed entrepreneurs. Apparent in the literature is the development of a string of characteristics that have taken on some degree of usage. These characteristics include need for achievement (McClelland, 1961 as cited in Gartner, 1989, p.47), locus of control, risk taking, tolerance of ambiguity and self-confidence. Timmons (1978) identified fourteen dominant characteristics of successful entrepreneurs. Among others these include drive and energy, self-confidence, goal setting, moderate risk taking and use of feedback. Robinson, Stimpson, Huefner & Hunt (1991) further include self-esteem and innovation. Despite much overlap in the variations of characteristics identified, "there is confusion about the constellation of relevant attributes" (Cromie, 2000, p.22). Still further, Busenitz & Barney (1997), from a more original perspective, argue that the use of biases and heuristics in decision-making are defining features of entrepreneurs. This in particular has ramifications regarding the venture capital model in terms of possible structural rigidities which may stifle entrepreneurial behaviours and motivations.

Diminishing Gartner's (1989) stance is empirical evidence of the abilities of entrepreneurs. It is widely recognised that those individuals who make good entrepreneurs don't necessarily make good managers. This is primarily attributed to incongruence between firm lifecycle demands, creating increasing need for systems, structure and predictability, and the entrepreneur's work style preferences, typically the antithesis of such demands (Churchill & Lewis, 1983; Kets de Vries, 1985). Fried & Hisrich, (1995) relate the relevance of this observation to the venture capital environment where entrepreneurs may be unsuited to managing latter-stage ventures.

Distilling the literature, it is clear that there is little consensus regarding an appropriate means to define entrepreneurs. Ultimately, there exists little support in the literature for the argument that entrepreneurs are unique in any manner from non-entrepreneurs, except at the moment of committing themselves to acting entrepreneurially.

In summary, current knowledge relating to the entrepreneur fails to confirm their possession of unique attributes. To-date the focal ambition of research into the fields of entrepreneurship and the entrepreneur appears to have been upon their definitions. The entrepreneur has been explored both in terms of personal traits, cognitions and attitudes, and also behaviours, under the proviso that one is not an entrepreneur without entrepreneurial actions. All the while, strong argument is made for the confounding role of context and environment, aspects of significant relevance to the current research.

1.2.3 The entrepreneur / VC relationship

Confusion pervades the literature about how best to conceive of the entrepreneur/VC relationship. However, because the relationship requires and manifests some level of cooperation to achieve its combined and individual objectives the primary focus of this section is upon these cooperative aspects.

Das & Teng define partner cooperation as "the willingness of a partner firm to pursue mutually compatible interests in the alliance rather than act opportunistically" (1998, p.492). They further claim opportunism to be the opposite of cooperation, defined by cheating, shirking, distorting information, misleading partners, providing substandard products/services and appropriating partners' critical resources. Schumacher (2001) makes the observation that scholarly investigation into cooperative behaviour has historically drawn upon a diverse range of academic disciplines. This has hindered the development of a clear approach to understanding the "formation, evolution and outcomes of alliances ... and identifying the parameters that account for co-operative behaviour" (2001, p.13). He implies that there has been little attempt to-date to synthesise and integrate the many streams of research on cooperative behaviour into a holistic and clear explanation of the phenomenon.

The design of cooperative alliances determines how they are controlled by parties to such alliances. Explained previously was that venture capital-financing relationships are referred to as minority-based equity alliances (Das & Teng, 1998). This specific classification is thought relevant by these writers, especially for characterising the interaction of control, trust and confidence in cooperative behaviours by alliance partners, as explored in section 1.3.4 to follow. Other theorists, including Gulati (1995) have tended to think of all equity sharing alliances as having essentially the same properties and only differentiate them with non-equity alliances, usually defined in terms of licensing agreements and similar. Equity-based alliances are essentially a cooperative based alliance between two firms involving "one party taking an equity stake in its partner" (Das & Teng, 1998, p.497). This is clearly the model applicable to venture capital-financed ventures, as already outlined. The reasons for formation of cooperative alliances are diverse and are explained by various streams of theory. These include, for example, economics-based perspectives, closely informed by transaction cost economics and resource dependency theory. Firms may enter such relationships in search of cost-saving and value-creating synergies, learning effects and risk reduction (via equity sharing). Transaction cost economic theory assumes economic-based advantages in cooperative alliances. Cooperation is typically pursued when the benefits of cooperating exceed the costs. Social structure theories are another explanation for cooperative alliances, and consist of social exchange theory, network theory and small group social behaviour studies (Schumacher, 2001).

The governance structures used for equity-based alliances are commonly explained by transaction cost economics which seek to reduce transaction costs. These mechanisms consist of the actual equity sharing, helping to "align the interests of the partners" (Gulati, 1995, p.89) and administrative systems used to oversee the daily running of ventures. Opportunism is assumed to pervade all aspects of organisational interaction when applying transaction cost economic theory (Moschandreas, 1997; Young-Ybarra & Wiersema, 1999). This effectively discounts the inculcation of trust-related considerations into equity-based alliance modelling. Supporting this perspective is a general recognition that equity-based ventures are hierarchical (Gulati, 1995), an assumption of the transaction cost economic approach, premised on equity apportionment between the cooperating parties. In general this approach to assessing the entrepreneur/VC relationship fails to account for alternative forms of interaction, that may be equally accessible by the parties and which rely on a more informal and social regimes of control.

The challenge for equity-based alliances is to achieve a mutually satisfactory level of cooperation. This is inherently problematic in a relationship where both contracting parties are automatically assumed to pursue maximum self-interest in the form of individual returns from the alliance, which are potentially detrimental to mutual gain (Schumacher, 2001). This assumption adheres to the homos economicus doctrine explaining the natural pre-disposition of man toward self-enrichment. If achievable, however, greater levels of cooperation can produce more efficient outcomes (Moschandreas, 1997). Cooperation in such relationships requires confidence by each party in the cooperative intentions of the other. Confidence, in this context, is defined by the level of certainty each party can achieve in the likely cooperation of their business partner. Das & Teng (1998, p.493) state, "a lack of confidence in partner cooperation may well abort a potential alliance".

1.3 Trust

This research project is premised on the importance of trust, with the objective of determining its interplay within venture capital-financing relationships. "Trust influences all commercial transactions and has to be included in the analysis of cooperative relationships" (Schumacher, 2001, p.52). Previous discussion has focused on contextual matters of significance to understanding these dynamics. The following narrative isolates the topic of trust. The literature is explored for a concise definition of trust, all the while referring to the venture capital-financing relationship for particular points of relevance and application of trust-related discoveries.

1.3.1 Overview

The concept of trust comprises great complexity. Though a loose, intuitive conception of trust is likely held by most people, identifying, defining, explaining, predicting and building trust has occupied and confounded the minds of many a writer for a long while (Rousseau et al., 1998). Trust-based research can be classified according to, for instance, individual and group trust, cognition and organisational theory (McAllister, 1995; DeClerq & Sapienza, 2001; Herzog, 2001; Williams, 2001; Korsgaard, Schweiger & Sapienza, 1995).

The study of trust in organizations has proved difficult for scholars. Mayer, Davis & Schoorman (1995) point to several reasons for this, including problems with definition, its relationship with risk, and confusion with antecedents and outcomes of trust. Butler (1991) further signals the complexities of trust, though he clarifies the difference between measuring the dimensions of the construct of trust and identifying the causes of trust (or mistrust). The latter he refers to as conditions of trust, an important distinction. These perspectives emphasise the multidimensional and situational nature of trust. Lewicki and Bunker (1996) citing Worchel (1979), summarise trust-related research by distinguishing three streams of attention. Constituting these streams is literature by 1) personality theorists, 2) sociologists and economists and 3) social psychologists. The two latter groups consider trust respectively in terms of being an institutional phenomenon and also consider the topic at an interpersonal level. The relevance of these two perspectives in terms of venture capital relationships is reinforced by Lewicki and Bunker, suggesting that interpersonal trust, for example, is subject to "contextual parameters and constraints" (1996, p.116) which define the level of risk in trust-based decision making.

Schumacher (2001), Rousseau (1998) and Lewicki and Bunker (1996) use a three-tier conception of trust which includes situation-based trust, character-based trust and institution-based trust. Each of these theories appears to have its own strengths in at least partially explaining the formation and diminution of trust, even as they may specifically apply to venture capital-financing relationships. However, what is apparent from reviewing the literature is that no single theory is capable of fully capturing the antecedents of trust, nor explaining its creation. For this reason, an even wider search for contextualising the exploration of trust within venture capital-financing relationships is needed. This important exercise is reviewed in chapter four to follow.

1.3.2 Definition

The recognised ingredients of trust include mutuality, reciprocation, hidden actions (Chami & Fullencamp, 2002), cooperation, altruism, ambiguity (Frost, Stimpson, & Maughan, 1978), vulnerability (Bigley & Pearce, 1998), risk and interdependence (Rousseau et al., 1998; Frost et al., 1978). Chami and Fullenkamp summarise various definitions of trust stating that one aspect essential to trust is "mutual or shared confidence between two people in some kind of relationship" (2002, p.6). They further make the point that "trust only has meaning in a context of asymmetric information" (p.6). This is debatable if considering a wider context for trust beyond obligation. Reliability, for example, does not necessarily rely upon asymmetric information for trust to have a role. Information asymmetry is also a catalyst for agency problems in organisations, as is apparent in the venture capital-financing model.

According to Bhattacharya, Devinney & Pillutla (1998) trust is a psychological state, not a behaviour or choice. This is debatable. One can surely consciously choose trust, via assessment of risk and reward within any situation and relationship. This idea is asserted by Mayer et al. (1995) when discussing the actionable component of trust. The definition of trust proposed by Mayer et al. is, "the willingness of a party to be vulnerable to the actions of another party based on the expectation that the other will perform a particular action important to the trustor, irrespective of the ability to monitor or control that other party" (1995, p.712). These authors note that trust is not taking risk per se, but rather it is a willingness to take risks.

Costa et al. (2001) assert that to-date little agreement on a definition of trust has been reached among writers in the field. However, they observe a convergence of ideas which seek similarity of trust components across numerous academic and intellectual disciplines. They also mention "positive expectations" and "vulnerability" as two critical ingredients that emerge from the literature. In their interpretation, these writers view trust as entirely attitudinal. Their explanation of trust is consistent with that of Mayer et al. (1995) in the view that trust has both a psychological state and behavioural component. They stress however a key distinguishing point of difference to other interpretations, in that behavioural aspects are components of, not effects of trust itself. Again, this view is consistent with Mayer et al. (1995).

McKnight, Cummings, & Chervany (1998) contribute to a definition of trust by dividing the concept into trusting beliefs and trusting intentions. The level of innately occurring propensity to trust relates to trusting beliefs. But this propensity, as rightly pointed out by previous writers, is insufficient to indicate trust. However, McKnight et al. (1998) stop short of introducing behaviour into their model of trust. Therefore, the two above components are restricted to what was previously described as mere "willingness" to trust. McKnight et al.'s (1998) model has no actionable part of trust, which negates aspects of risk and vulnerability. However, support for context is indicated by their perspective in that trusting intention may, by definition, be context-specific. Referred to as institution-based trust by these writers, it manifests only under conditions of security, as afforded by institution-based mechanisms. These include contracts, forms of governance and various fiduciary responsibilities. In essence, these are formal mechanisms which act in a quasi-trust capacity as surety to the parties. Effective institutional mechanisms of monitoring and control may contribute to high initial trust between relational parties, partly explaining their presence in venture capital agreements.

Rousseau et al. (1998) assert the complexities of trust due to the array of definitions across a multitude of scholarly perspectives. For this reason, these writers attempt to provide a cross-disciplinary view of trust; one that encapsulates a universal understanding of the concept and cuts across disciplinary idiosyncrasies. This effort is informed by their view that, "to date, we have had no universally accepted scholarly definition of trust" (p.394). These writers conclude the critical components of trust, across all current definitions are, "confident expectations" and "a willingness to be vulnerable" (p.394), placing the discussion into the interpersonal trust camp. Importantly, they state that trust is not a behaviour but an underlying psychological condition or state. Noting Rousseau et al. (1998), context is critical to understanding trust, greatly assisting comprehension in the current research. Asserting the importance of context in shaping the manifestation of trust, Costa, Roe & Taillieu (2001) break trust into four attitudinal and behavioural components consisting of propensity to trust, perceived trustworthiness, cooperative behaviours and monitoring behaviours. The interaction of all four components differs from one context to the next.

Risk appears to be closely associated with trust development. Mayer et al. (1995, p.724) state, "There is no risk taken in the willingness to be vulnerable (i.e. to trust), but the risk is inherent in the behaviour manifestation of the willingness to be vulnerable". Of relevance to the venture capital model, they make the point that an individual's assessment of the level of risk in any situation is context dependent, with judgements based on "familiarity of the domain of the problem, organisational control systems and social influences" (1995, p.726). Further, the consequences of trust are also context dependent and rely on the "stakes involved, the balance of power in the relationship, the perception of the level of risk and the alternatives available to the trustor" (1995, p.727). Citing Chami and Fisher (1996), Chami and Fullenkamp mention, "risk sharing is a powerful motivation for building up trust" (2002, p.19). The preceding observations are quite relevant to the entrepreneur/VC paradigm in that a conjoint equity stake is held in the venture and responsibility for venture success is shared between the two parties. Risk is shared and the rewards, from equity apportionment, create a powerful incentive to engage trust within the relationship, especially given the futility in trying to contract for every possible contingency.

Shepherd & Zacharakis (2001) consider the issue of trust and its benefits within the entrepreneur/VC relationship by focusing on cooperation and commitment. They claim that trust is necessary for the latter to be present. Further, these writers extend what they believe to have been the dominant approaches in the literature to the entrepreneur/VC problem, agency theory and prisoner's dilemma, to create a model for building trust. This model consists of four pillars – 1) signalling commitment and consistency, 2) being fair and just, 3) obtaining a good "fit" across a range of personal traits between partners and 4) frequent and open communications, the latter being a recurring theme through most discussion on particularly the formation of trust.

Finally, an outstanding summary of manifest behaviours resulting from the level of trust (or mistrust) in a relationship comes from Zand (1972, p. 230), as follows.

> One who does not trust others will conceal or distort relevant information, and avoid stating or will disguise facts, ideas, conclusions and feelings that he believes will increase his exposure to others, so that the information he provides will be low in accuracy, comprehensiveness, and timeliness; and therefore have low congruence with reality. He will also resist or deflect the attempts of others to exert influence. He will be suspicious of their views, and not receptive to their proposals of goals, their suggestions, for reaching goals, and their definition of criteria and methods for evaluating progress.

The above review of the literature on trust provides useful direction and support for the current research despite definitional problems. The many overlapping definitions apparent in the literature do at least provide a feel for the predominant thinking on the subject. At a generic level, trust is defined by:

- Vulnerability
- Asymmetric information

- Risk
- Reciprocation and cooperation

Particularly relevant to this study is the impact of context upon the above definitional criteria. The venture capital-financing model attributes described in section 1.1.2 closely reflect many of the ingredients of trust revealed in this section. In particular are the contractual rules (institution-based mechanisms) of monitoring and control implemented by the VC and entrepreneur to ameliorate and facilitate each of the trust ingredients outlined in the above bullet points.

Moreover, these trust definitional criteria above provide a useful framework for understanding how trust develops in relationships. In the following chapter a range of theoretical propositions are explored to assist comprehension of the development of trust.

1.3.3 The importance of trust

Above all else, it is necessary to qualify an implicit caveat of this research topic. That is, trust is important, creates tangible benefits and adds value. Arguments supporting this caveat are presented in the following discussion.

"The building of trust relationships between the entrepreneur and the informal investor [VC] appears to be essential for successful capital investments on the part of the investor to take place" (Harrison, et al., 1997, p.77). Wicks, Berman, & Jones assert the importance of high trust relationships, stating, "Without high trust, stakeholders may attempt to extract higher rents, refuse to cooperate willingly, and fail to identify with the firm's interest, all of which can add agency and transaction costs, as well as undermine the potential to generate the key benefits of an interdependent relationship" (1999, p.109). These writers correlate firm performance with the level of trust in relationships between managers and stakeholders.

Despite such observations of the link between trust and performance, it is apparent that the strategic value and value-adding properties of trust to firm performance have received little attention in the literature. Cook and Wall (1980), for instance, only draw a link between trust, firm stability and member well-being. The importance of trust is noted by Herzog, who states "trust is the foundation upon which we build successful and profitable collaborations" (2001, p.29). Chami and Fullenkamp continue to cite the importance of trust within firms, stating, "when trust is present in a firm, this does indeed raise productivity relative to non-trusting firms" (2002, p.8). Trust within the entrepreneur/VC relationship has potentially significant strategic value in itself. Trusting behaviours between entrepreneurs and VCs may be viewed not solely as a counter-balance to costly control requirements, but as a mechanism by which the relationship, and therefore venture performance can be improved. In its own right, trust, though intrinsically intangible, may be considered a strategic asset in any venture.

It is apparent from the previous discussion that trust is a naturally occurring, intangible and positive influence upon relationships. Further support for this position is offered by Costa et al. (2001) who cite four positive affects of trust. These include better task performance, higher team satisfaction, improved relationship commitment and stress reduction, all contributing factors to the level of success of venture capital-financing relationships.

1.3.4 Control and trust

The earlier discussion of cooperation between entrepreneurs and VCs comprises an inherent question of control. What is control and what is its purpose? How is it obtained and exerted in these relationships? What is the relationship between control and trust? The following inquiry examines these issues.

Control and trust are commonly viewed as the two sources of confidence in the behaviours of strategic partners (Das & Teng, 1998). However, these writers also claim that it is a mistake to think of one as a substitute for the other, due to their influencing confidence in partner cooperation in quite different ways. Trust is an expression of belief in, and desire for goodwill by a trustee, which may express in increased levels of cooperation by the trustee. Control on the other hand is direct action taken to affect a level of confidence in cooperation. Das & Teng (1998) support this description and further disagree with existing conceptions of control and trust as complementary in terms of having an inverse relationship. Instead, relying upon their supplementary conception of the interaction between trust and control, they state, "a higher trust level does not automatically dictate a lowering of the control level and vice versa" (1998, p.496). However, they also make the observation of a general lack of clarity in the literature with regards the relationship between control mechanisms and trust. These same writers explore different types of control, referring to formal control and social control, the former relying upon rules and regulations (agency theory concepts), the latter "utilising organisational values, norms and cultures to encourage desirable behaviour" (1998, p.501) approximating the prisoner's dilemma perspective. Rodriguez & Wilson (2002) refer to the former using the intuitive description "structural bonding".

A combination of control and trust has commonly been considered necessary for examining cooperative relationships (Shepherd & Zacharakis, 2001). However, the suggestion that the two are complementary is challenged by Das & Teng (1998), as already indicated. This is to say that more trust does not necessarily mean less control, and vice versa. There appears a risk though that within an organisation, perceived excess of control in terms of monitoring and restrictions may impact the development of trust (Moschandreas, 1997; Das & Teng, 1998). Further research by the latter writers indicates that despite this detrimental relationship between trust and control, it appears also that, structured appropriately, high levels of control can also foster trust. The literature does not reveal firm conclusions to these opposing propositions.

Two theoretical approaches to analysing the issue of control and trust in entrepreneur/VC relationships dominate the literature (Shepherd & Zacharakis, 2001). The two approaches are agency theory and prisoner's dilemma, both explored in thorough detail in chapter 1.4. These theories assume control within the venture company is achieved by quite different means. An assumption of opportunistic propensity, as expressed by some writers on this subject (Moschandreas, 1997), pervades both theories (Eisenhardt, 1989). Examining the venture capital-financing model through these two theoretical lenses is an effective way of also examining the role of trust within these relationships. The first specifies that the rules and regulations of a typical hierarchical organisational structure are appropriate, given the hierarchical nature of the relationship between the entrepreneur and VC. In this case the agent-principal split is apparent in the entrepreneur/VC relationship respectively. As the VC is not readily in a position to closely monitor the activities of the entrepreneur, the latter is assumed to tend toward opportunistic behaviours. Conversely, using the prisoner's dilemma approach, the design of the relationship in terms of equity sharing and similar entrepreneur/VC objectives, manifest its own controls in the way the parties interact with one another. The relationship itself may be thought of as a self-correcting mechanism, encouraging the parties toward cooperative behaviours therefore reducing the importance of contrived control with rules and regulations. Larson (1992) argues that this form of alliance inherently consists of mutual cooperation and reciprocity, hence the reason governance mechanisms based on opportunism generally fail. Eisenhardt (1989) would argue that mutual cooperation and reciprocity is the product of reduced goal conflict between entrepreneurs and VCs (mostly due to equity sharing arrangements).

Shepherd & Zacharakis (2001), having screened the literature, suggest confusion about the antecedents to levels of control and trust in relationships. However, they concur that control and trust can co-exist because the presence of one does not preclude the existence of the other. They state, "Somewhere between these two extreme levels of control (minimal control and maximal control) is an optimal level that allows and encourages trust in the relationship to be developed" (p.139). This view suggests an inverse relationship between trust and control, but that ideally a point of natural equilibrium is attained. Arguably, the point at which such equilibrium is reached also contributes to venture performance. As already indicated, if a higher level of trust within relationships is associated with higher performance, then although finding natural equilibrium may seem desirable, all equilibriums may not be equal. It seems possible that equilibrium in relationships is in fact the point at which the parties perceive (consciously or not) an absence of mistrust. This then may be equilibrium but fails to recognise the prospects of raising performance via increasing trust further and reducing levels of control and monitoring (and therefore associated costs, both tangible and intangible).

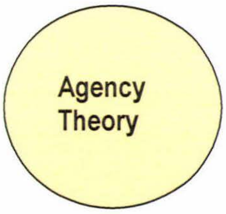
Concluding the current chapter, trust is clearly a complex phenomenon. Only a cross-disciplinary examination of the concept permits insights necessary to understanding the antecedents and outcomes of trust. Extant literature exhibits a partitioning of many disciplinary facets of trust, hence the dearth of definitive conclusions and explanations to aid comprehension of the topic. Review of the literature reveals theoretical developments relying upon economics, social sciences, organisational development, philosophy and management studies. There are, however, certain consistencies which appear in the literature. For instance, vulnerability, confident expectations, risk, reciprocity and cooperation are recurring definitional attributes of trust. The importance of the relational context, or domain of interaction, is also iterated in the literature, as is acceptance of a combined psychological and behavioural mixture to trust manifestation.

1.4 The Development of Trust – A Multi-theoretical Approach

This chapter explores the determinants of trust development in formal relationships. Five theories are identified as contributing valuable perspectives to understanding this phenomenon. The five theories are agency theory, the prisoner's dilemma theory, procedural justice theory, social exchange theory and interpersonal trust theory. A conceptual tool is derived from the components of each theory, referred to as the trust development construct. This construct is intended to serve two roles. Firstly, it is necessary to inform the empirical information gathering needs of this study. Secondly, it allows later theoretical analysis of the trust development model, developed from empirical findings of this research and presented in the "Discussion" chapter of this thesis in Part IV.

1.4.1 Agency Theory Perspective

Figure 1



Agency theory has been a popular conceptualisation of the entrepreneur/VC relationship (Sapienza & Gupta, 1994). However, there also exists contradicting opinion as to the suitability of this conception (Cable & Shane, 1997; De Clercq & Sapienza, 2001). For this reason, Eisenhardt (1989) for one, recommends using agency theory concepts only in conjunction with complementary organisational development theory. She argues that, "additional perspectives can help to capture the greater complexity" (1989, p.71) of cooperative relationships. This is the approach used in the current research to explore the development of trust in the venture capital-financing model.

Eisenhardt states, "… the domain of agency theory is relationships that mirror the basic agency structure of a principal and an agent who are engaged in cooperative behaviour, but have differing goals and differing attitudes towards risk" (1989, p.59). Any discussion of trust within organisations cannot be complete without consideration of agency issues. Agency theory has its basis in moral hazard (Shepherd & Zacharakis, 2001) and asymmetric information (Markman et al., 2001; Cable & Shane, 1997; Sapienza & Korsgaard, 1996), where self-serving behaviours in individuals are anticipated. The individual, it is assumed, will generally always act in his or her self-interest, even if to the detriment of the other related parties. De Clercq & Sapienza state quite clearly the problem with this reality. "Venture Capitalists and entrepreneurs do not obtain the full potential of their relationship when their behaviour is guided by opportunism" (2001, p.123).

Agency theory suggests, "...the greater the information advantage possessed by inside members, the greater the danger that pursuit of self-interested outcomes at outsider's expense will go undetected" (Sapienza et al., 2000, p.336). More precisely, "the agency problem occurs when the goals of the principal and agent are different, and when it is difficult for the principal to know what the agent is actually doing" (Eisenhardt, 1989 cited in De Clercq & Sapienza, 2001, p.108), presumably acting in a manner which does not maximise shareholder wealth (Laing & Weir, 1999).

Application of agency theory to the entrepreneur/VC relationship is problematic in the sense that this type of relationship does not necessarily fit an agency problem model. Generally speaking, the agency theory approach implies a principal-agent context with a concomitant power differential between the parties. "The agency perspective describes the relationship in only one direction; it focuses on VC control over the entrepreneur's opportunistic behaviour while ignoring the entrepreneur's concern that the VC may act opportunistically" (Shepherd & Zacharakis, 2001, p.133). Because of the power spread readily apparent in the entrepreneur/VC paradigm, the potential exists for both parties, at various stages of the venture lifecycle to act opportunistically. This suggests that it is in the best interests of both parties to interact cooperatively at all times, particularly given the apparent power shift throughout the course of such ventures and the possibility of *tit-for-tat* retaliatory behaviours.

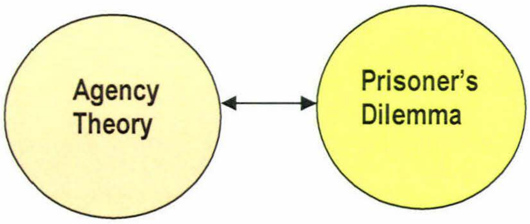
The traditional agency approach to the entrepreneur/VC relationship is tenuous in its application, a view supported in the literature (Wright et al., 2001). The argument here, as in much of the literature, is that agency-based control mechanisms are a *poor second cousin* to the potential gains from a trust-based approach. Wright et al. support this view stating, "... agency theory is limited in its power to explain how incentives and monitoring mechanisms contribute to enhancing performance" (2001, p.244).

Although at face value agency issues seem unavoidable in any business relationship, particularly those which conform more readily to a hierarchical model, Chami & Fullencamp (2002) identify from the literature two general strategies for dealing with such issues. The first strategy is to attempt to diminish agency problems via monitoring mechanisms. The second, "superior" strategy is to "align the incentives of principal and agent" (2002, p 3). The latter strategy seems more intuitively appealing for the ideal entrepreneur/VC model, indeed possibly for most forms of business interaction. Logically, entrepreneurs and VCs must share the same objectives at some level, even if only in terms of a desired financial reward. However, incentives can be contemplated in either economic or emotional terms.

Rodriguez & Wilson (2002) cite structural and social bonding as two streams of interaction for development of "social capital". Structural bonding relies on economic-based concepts to create commitment within a relationship and consists largely of contractual mechanisms. Social bonding, on the other hand, has closer affiliation with psychological aspects of cooperation. These are influenced by friendship and personal confidence for example. In this context, the two streams are related forms of incentive that, when pursued in interdependent relationships, foster trust and commitment from each party. Furthermore, where resource dependence is disparate between the parties, social bonding is effective in ameliorating perceptions of inequality and building trust. In the context of facilitating the development of social capital, Rodriguez & Wilson state, "trust, when nurtured, generates manifested cooperative behaviour, long-term commitment, and less uncertainty in the relationship" (2002, p.70). These writers stipulate, however, that for a relationship to acquire trust a minimum level of dependability and reliability is necessary. The only way to achieve these attributes is by firstly establishing structural capital. Only then may social capital develop. Such a proposition resounds of the complexities proposed by writers Das & Teng (1998) and Shepherd & Zacharakis (2001) where control and trust are not necessarily complements or substitutes, and where striking an effective equilibrium between the two seems extremely challenging.

1.4.2 Prisoner's dilemma perspective

Figure 1.2



(Arrows denote relationships between theories)

The prisoner's dilemma approach to explaining cooperation in the entrepreneur/VC relationship provides an alternative conceptualisation to that of the agency theory perspective. The approach does not place emphasis on a principal-agent paradigm where formal control mechanisms are needed to protect the interests of the principal, ostensibly the VC, from opportunistic actions by the agent, the entrepreneur. The incentives for cooperation according to the prisoner's dilemma perspective are assumed to be aligned by the sharing of venture company ownership between the parties. Further, the theory makes allowance for the role of trust to encourage cooperative behaviours. This is not the generally the case with respect to agency theory literature, despite some exceptions indicated previously. Informal means of control take preference in governing the behaviours of the parties to the entrepreneur/VC relationship.

Cable and Shane (1997) offer an intriguing inquiry into the prisoner's dilemma perspective. As has already been indicated, these authors suggest that "modelling VC relationships as a principal-agent problem appears unduly restrictive given the potential for opportunistic, uncooperative actions by VCs as well as entrepreneurs" (1997, p.168). Taking a wider perspective, De Clerq & Sapienza (2001) are critical of much of the literature that focuses only on the "purely economic" approach to the entrepreneur/VC relationship. Their view is that too much emphasis has been placed on attempting to understand cost and risk reduction strategies rather than "how members of the entrepreneur/VC dyads can create value from their association" (2001, p.109). Alluded to previously was the idea that trust may be a catalyst for reaping such value.

Sapienza et al. claim that "this theory [agency theory] has been the dominant perspective on corporate governance and the one most frequently applied to venture capital-backed firms" (2000, p.336). This tendency appears to have resulted from a general misunderstanding of the entrepreneur/VC financing paradigm. This paradigm is described effectively by Cable and Shane (1997) citing "knowledge specificity" as affording each party a comparative advantage, the basis of their prisoner's dilemma approach.

Despite the somewhat mechanical nature of prisoner's dilemma analysis, trust is still a critical component, hence its relevance to this research. The prisoner's dilemma describes four generic options involving varying degrees of cooperation between two parties. According to the approach, the dynamic and evolving nature of social relationships constrained by unpredictable and opportunistic behaviours by individuals mean that trust, or lack thereof is a fundamental ingredient. Cable & Shane capture the relevance of trust by stating, "true to the prisoner's dilemma, both parties can maximise their joint rewards through mutual cooperation" (1997, p.151). For cooperation to occur and accrue benefits to either one or both parties, trust must be present. The advantage of examining the relationship through the prisoner's dilemma lens, according to Cable & Shane (1997) is that, contrary to the traditional agency theory approach, prisoner's dilemma incorporates the dynamic nature of the entrepreneur/VC relationship.

The essence of the prisoner's dilemma concept is that "each individual actor has an incentive to act according to competitive, narrow self-interest even though all actors are collectively better off if they cooperate" (Cable and Shane, 1997, p.145). The advantages of this framework, according to these authors are that it "incorporates the issues of uncertainty and goal conflict that underlie agency theory without the restrictive assumption of a hierarchical relationship" (1997, p.147).

As agency theory prescribes formal control for cooperative behaviour, the prisoner's dilemma approach explains control by indirect means and without necessarily formalised mechanisms. This is achieved via the availability of non-cooperation penalties. The threat of use of such penalties such as withholding tranched venture finance (formal) and even technical knowledge retention by the entrepreneur (informal) for example, is ultimately the coercive construct toward cooperation. In terms of value creation, entrepreneurs and VCs may pursue the minimum-required levels of cooperation for measurable success, but not inspire them toward maximising value creation by pursuing the full potential of trust.

The prisoners dilemma explanation suggests that information asymmetry between the parties at all times tends them toward relationship defection when confronted with opportunity costs. Further, the outcome of all interaction is a level of cooperation, whether high or nil. Cable and Shane (1997) cite eleven determinants, or predictors, of the level of cooperation between the entrepreneur and VC. Examples of these include, payoff to cooperation, frequency and quality of communication, social relationship aspects, power relativity, bonding mechanisms and displays of generosity. The level of cooperation at any time in the relationship is a factor of the complex interaction among all these determinants. To complicate matters, the fluid nature of power across the term of the venture is caused by the constantly changing and evolving level of potency of each variable in the mix at any given time (Cable & Shane, 1997). Importantly, prisoner's dilemma theory, as suggested by these authors, illustrates that "entrepreneur/VC relationships may be enhanced if they have a relational as well as transactional component" (1997, p.171). This belief is rooted in the idea that social relationships foster trust, generosity and reciprocity.

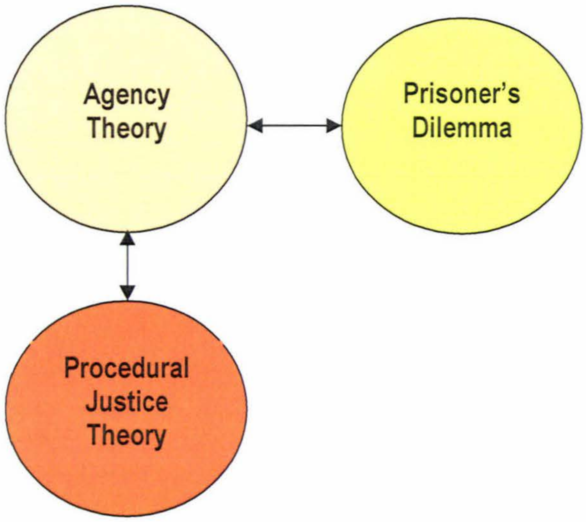
Applying the prisoner's dilemma approach to explaining trust within the entrepreneur/VC dyad has two notable aspects. The first is an assumption of paradigm constancy, meaning the forces acting upon the relational partners are permanent but subject to manipulation and fluctuation. Secondly, the approach assumes the paradigm is essentially destructive and that inculcation of trust, by whatever means, is the elixir of success. However, despite being moderately prescriptive in referring to open communication, mutual cooperation, procedural justice and equity theory, no allowance is given to the actors and their individual propensities to be trusting and trustworthy. A further caveat is that they are inspired equally by the same overall goal and so equally committed to the pursuit of success. Prisoner's dilemma theory, as with other cooperation-based theory, fails to consider the propensity of individuals to the relationship in their capacity to implement the prescribed mechanisms necessary for trust. Effectively, the model assumes complete individual pragmatism across the term of the relationship. This, one may argue, is unrealistic.

The work of Barney et al. (1996) provides a conflicting representation of the traditional entrepreneur/VC paradigm to that described and used for discussion in this research. This work (1996) has consequences for the paradigm, particularly in light of the previous discussion, whereby the development of trust is fundamental to the relationship and organisational learning increases value creation. Cable and Shane (1997) for instance, argue that the prisoner's dilemma approach to the entrepreneur/VC issue implies cooperation and communication for development of effective relational behaviours and trust are essential. This further requires that perceptions of control and power within the relationship are ultimately balanced by participant interdependence, due to the assets and knowledge contributed by each party. In light of Barney et al.'s (1996) study, this balance may not be as determinable as previously thought. These authors claim that entrepreneur acceptance of VC managerial and operational advice is dependent on variables of new venture management team experience, team tenure, and venture technical complexity. More interestingly, this research shows that, "VC backing only marginally improves venture performance following an initial public offering" (1996, p.259). These results have implications for the entrepreneur/VC paradigm in terms of power. Seemingly, Barney's findings imply a diminution of power for the VC in terms of non-financial contribution. Any restructuring of the power distribution within the relationship logically impacts the necessity for, and level of, trust development. Also, formal control mechanisms may be preferred because a greater agency problem arises.

The level of cooperation achieved within these relationships can be measured in terms of information exchange between the parties, transaction cost reductions and creation of value. The most appropriate theoretical basis for describing the entrepreneur/VC relationship is unclear, however two additional theories provide a valuable contribution to this discussion. Their explanations of the cooperation problem complement both agency theory and the prisoner's dilemma approach already discussed. Most closely related to the discussion on agency theory is the concept of procedural justice, and supporting the prisoner's dilemma argument is social exchange theory. These theoretical concepts are explored below.

1.4.3 Procedural Justice Theory

Figure 1.3



Procedural justice theory, in the view of Sapienza & Korsgaard is a "powerful framework for understanding the impact of decision procedures on intra-firm relations" (1996, p.546). Procedural justice theory makes no assumption about the structural environment of relationships, but instead focuses on the interactive processes among people within the relationship. In this way, the theory permits understanding of how trust may develop within relationships, including those where agency theory restrictions would normally apply. Given the confusion about the most appropriate conceptualisation of the entrepreneur/VC relationship, procedural justice theory helps to explain the development of trust despite the context. This is a view supported by Busenitz, Moesel, Fiet & Barney (1998).

Procedural justice theory has roots in organisational justice theory, with related concepts including equity theory and distributive justice theory. These latter theories concern themselves with explaining cooperation in hierarchical organisation environments based on perceptions of fair outcomes. By definition, "Procedural justice theory is concerned with the impact of the fairness of decision-making procedures on the attitudes and behaviour of the people involved in and affected by those decisions" (Korsgaard, et al., 1995, p.63).

Busenitz et al. go on to state, "when the process by which decisions are made is viewed as fair by those affected by it, higher-order attitudinal forces such as trust, commitment to the decision, and social harmony tend to result" (1997, p.7). The concept of procedural justice relies upon process to engender trust within relationships.

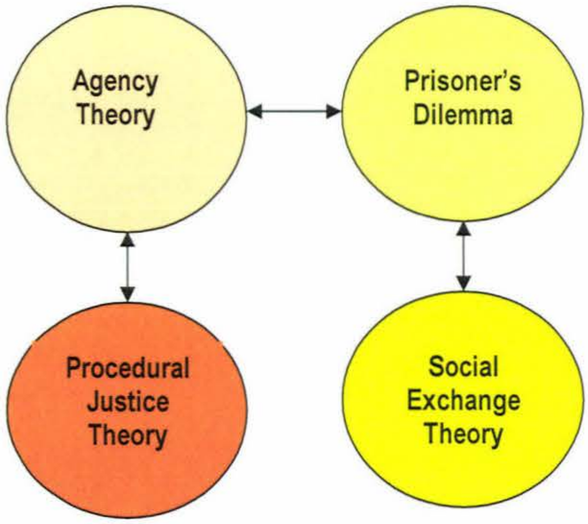
Agency theory implies concern for costs incurred by agent appropriation of resources. The typical solution to counter such risks is evident in control systems employed. Control mechanisms might include increased agent monitoring and elaborate contractual agreements. Reporting structures are also typically robust to ensure behavioural fidelity. Procedures and rules are typically deployed to discourage ambiguity and encourage predictability and accountability. Trust is innately antithetical under such regimes. However, the merit of procedural justice is that even in such rigid environments, transparent fairness in decision-making processes encourages cooperation and trust from recipients of decisions. Perceptions of fairness, according to Korsgaard et al., (1995) depend upon 1) consideration of agent input by decision-makers and, 2) agent influence over decisions.

Van den Bos, Wilke and Lind (1998) argue that procedural justice is only relevant to perceptions of trust where those affected by decision-makers' decisions do not have existing knowledge of the decision-maker's trustworthiness. Sapienza & Korsgaard (1996) focused their research efforts on the role of feedback in entrepreneur – investor relationships, when examined through the mediating influence of procedural justice. Their interpretation of the relationship put the VC in an information deficient position and heavily reliant upon the supply of information from the entrepreneur to stay abreast of venture progress. Accordingly, where feedback is inadequate in the opinion of VCs, their trust in the entrepreneur is reduced. This may even increase the level of monitoring by the VC of the entrepreneur's activities. Such a response risks a spiralling effect of further reducing trust from the latter toward the former.

The measure of procedural justice is perceived fairness in decision-making. Extending the view of Sapienza & Korsgaard (1996), it seems prudent to consider that perceptions of such fairness work in both directions and judgements are likely to be made by both VC *and* entrepreneur. The manner in which VCs handle their decision-making processes could be expected to be just as important as those conducted by entrepreneurs. This is particularly the case where, for example, VCs pursue contractual recourse for inadequate entrepreneur performance. Hence, the complementarity of procedural justice theory and agency theory explains the entrepreneur/VC relationship dynamic not readily understood by each theory alone. In fact, inclusion of procedural justice theory in the trust construct developed for this research arose from this complementarity.

1.4.4 Social Exchange Theory

Figure 1.4



Social exchange theory offers another particularly relevant perspective for analysing and explaining trust development within venture capital-financing relationships. This observation is increasingly prevalent in the literature involving strategic alliance research (Young-Ybarra, & Wiersema, 1999). Social exchange theory assists in explaining the relational dynamic across the term of intra-firm ventures. The *theory* places significant emphasis on the importance of social capital in its ability to "lubricate the workings of the relationship" (Rodriguez & Wilson, 2002, p.56). Importantly, social exchange theory offers an explanation for cooperative behaviours in relationships representative of the prisoner's dilemma conception, affording complementarity to the latter. Social exchange theory relies upon the premise that "business relationships are driven by economic and material benefit as well as social ties that build on acceptance and closeness with partners" (Rodriguez & Wilson, 2002, p.70).

Emerson argues social exchange theory to be a "frame of reference, within which many theories... can speak to one another" (1976, p.336), rather than a theory at all. This description bears similarity to prisoner's dilemma concepts in terms of incorporating both economic and social considerations, the latter of which includes trust-based issues. These similarities resemble the inter-disciplinary nature of the concept of trust, as already discussed.

Emerson (1976) also claims that existing literature relating to social exchange theory exhibits conceptual confusion, due largely to the fusion of economic ideas and individual actions and decisions within the field of sociology. Equally critical are Lawler & Thye (1999) who suggest that most approaches to social exchange theory literature are guided by "metatheoretical conceptions" which treat individuals as "unemotive beings" guided by only economic imperatives for collaboration. Regardless, social exchange theory is relevant to this research because of its inherent focus on the development of social capital and trust. Such considerations are typically absent from economics based approaches to the discussion of cooperation.

Opportunistic, self-serving, defection behaviours in game theoretical-type relational situations are diminished by the presence of a social bond between the parties. Social exchange theory posits that over time, parties to a relationship engage in frequent interactive activities and so develop knowledge of each other's behaviours and personalities (Hallén, Johanson & Seyed-Mohamed, 1991). As the relationship progresses from being purely cognitive-based to affective-based (McAllister, 1995) the bond that develops encourages the development of social mechanisms, including trust. Rodriguez & Wilson (2002) substitute structural and social bonds for cognitive and affective descriptions of relationships. They clearly state that structural bonds are necessary before social bonds can form, due to mutual initial vulnerability and uncertainty between relational parties. Structural bonds may also be considered asset-specific investments (Cable & Shane, 1997) which contribute to interdependence in the case of venture capital relationships.

The parties to a relationship can actually engage in behaviours which proactively increase their level of trust in each other, as mooted by Cable & Shane (1997). Rodriguez & Wilson state, "processes of social exchange, which originate from pure self-interest, generate trust through their recurrent and gradually expanding character" (2002, p.57). The evolving relationship and increasing willingness of commitment by each party to the relationship generally results in ever increasing interdependence. This evolution can be expected to continue as long as the parties perceive benefit from continued cooperation. This refers to reciprocality, commonly recognised as a necessary ingredient of the theory.

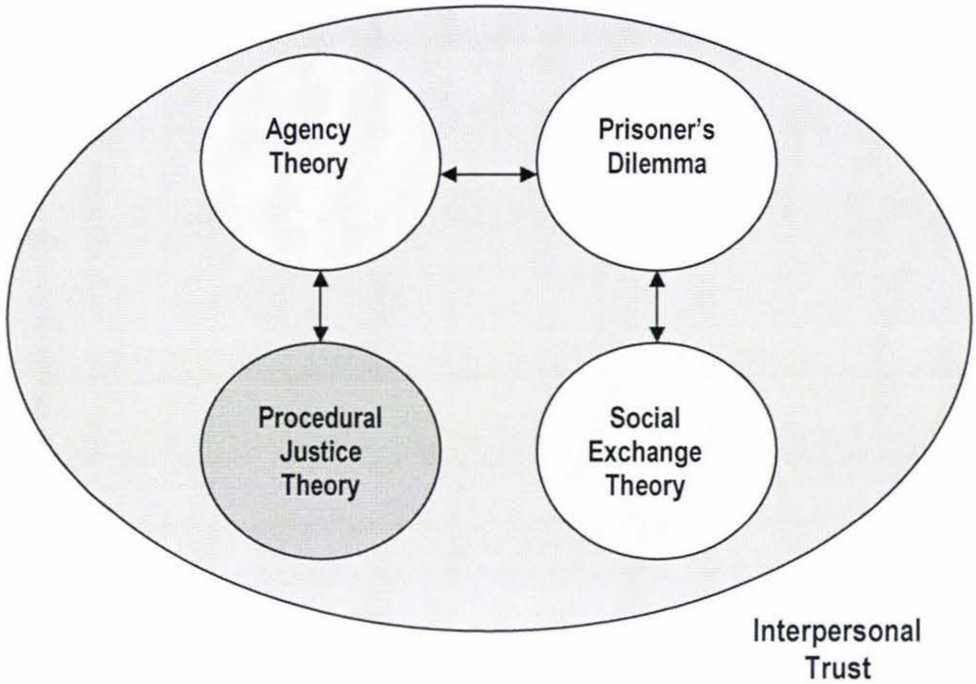
De Clercq & Sapienza (2001) refer to relation-specific investments as important determinants of commitment by VCs and entrepreneurs to their relationship. They (2001) argue that each party invests specific knowledge and experience in the relationship, teaching the other, and thereby further committing themselves. Such knowledge consists of managerial expertise or industry know-how for example.

Social exchange theory is an effective tool for analysing venture capital relationships. Its reciprocity concept implies that where mutual gain is maintained by reliance upon the unique resources contributed by each party, the relationship will prevail. Of particular relevance to the venture capital model using this conception is consideration of power dependency between the parties. The theory assumes one or both parties to a relationship will engage in some degree of adaptation to meet the needs of the other (Hallén, Johanson & Seyed-Mohamed, 1991). Adaptation by either party is an expression of trustworthiness, with an expectation of a later payoff in terms of some form of benefit, especially necessary of long-term relationships. In terms of the venture capital-financing relationship, the perceptions of power held by either the entrepreneur or the VC in their counterpart will depend on their level of resource dependency in the other. This helps to explain the establishment by VCs of extensive contractual safeguards and tranched capital injection at the start of relationships. Such measures are intended to prevent the entrepreneur's defection from the relationship, over which the VC has little non-contractual control. The structural bonds may be mollified in their importance as the relationship progresses, as described by social exchange theory, as social capital and trust develop. Research findings by Young-Ybarra, & Wiersema, (1999) confirm this expectation.

Social exchange theory has a complementary relationship with the prisoner's dilemma approach, but also economic theory for explaining the entrepreneur/VC relationship. It's inclusion in the multi-component trust development construct used in this research project is based on this complementarity. Hallén, Johanson & Seyed-Mohamed, reinforce this decision by suggesting that although economic theoretical approaches are relevant for the study of economic relationships, "business relationships also include social aspects" (1991, p.31).

1.4.5 Interpersonal Trust

Figure 1.5[6]



The New Penguin Compact English Dictionary (2001) defines "interpersonal" as "involving or dealing with relations between people". This simple description is the basis for defining interpersonal trust, as evidenced in the following quotations.

Johnson-George & Swap claim, "Interpersonal trust is a basic feature of all social situations that demand cooperation and interdependence" (1982, p.1306). Rotter, a seminal author on the subject, defines interpersonal trust, "as an expectancy held by an individual or a group that the word, promise, verbal, or written statement of another individual or group can be relied on" (1971, p.444). McAllister, in a similar vein, defines the term as, "the extent to which a person is confident in, and willing to act on the basis of, the words, actions, and decisions of

[6] Figure 1.5 represents interpersonal trust as having commonality with all four theories explained previously, yet also as a distinctive phenomenon relevant to the trust construct undergoing development in this research.

another" (1995, p.25). This author states that knowledge and good reasons serve as foundations for trust decisions.

These definitions are grounded in research describing two forms of trust; affect-based trust and cognition-based trust. Firstly, reliability and dependability must be present for interpersonal trust to exist, and these are the product of cognition-based trust. Devine (1999) claims that cognition-based trust forms before affect-based trust. This linear perspective is challenged by Williams (2001) who purports that affect influences cognitions, motives and behaviours of trust. Devine (1999), however, claims that cognitive conflict risks inducing affective conflict. These definitions, when combined, form the necessary ingredients for the establishment of interpersonal trust. Interpersonal trust requires formal bonding, which instigates cooperation and interdependence in an entirely practical sense, but also consists of social interaction, producing sincerity and dependability.

Roy and Dugal widen the field of antecedents for interpersonal trust, stating, "most definitely trust, developed through communication, has been established as a prerequisite to successful collaboration" (1998, p.563). These authors also seek to explain the importance of the task environment (venture capital context) and cognitive flexibility (innate character) for the development of trusting relationships. A study conducted by these authors discovered that groups consisting of individuals with homogenous levels of cognitive flexibility are more trusting than groups with individuals with opposing levels of cognitive flexibility. Quite simply, individuals are more trusting of those who share similar mental structures with themselves.

Likewise, a greater implication regards the topical issue of governance and board structure. In essence, the results of Roy and Dugal's (1998) research challenge the concept of board diversity in particular, but reinforce group composition as important for the development of trust. This supports other research implying homogeneity of groups is necessary for heightened performance. The views of Van der Walt, Ingley & Diack (2002) regarding the link between governance architecture, ownership type, and performance outcomes may be construed also to suggest board homogeneity, if suited to improved trust and therefore performance in venture capital-financed ventures, is desirable. They (2002) make the insightful distinction between *corporate* governance and *organisation* governance in the vein of one size likely *doesn't* fit all.

Typically, people differ in their inherent propensity to trust (Mayer et al., 1995) but encouragingly, are naturally inclined toward trusting others (Chami and Fullenkamp, 2002). Mayer et al. (1995) assert that propensity to trust is stable across situations. This is a fair assessment if assuming of course that the actual risk-taking actions are what adjust in any given context, once assessment of context is possible. Propensity to trust is external to the context and therefore, correctly, independent of contextual influences. Contextual factors may dissuade or otherwise from commitment to vulnerability on the part of the trustor.

McAllister states that, "ultimately, the emotional ties linking individuals can provide the basis for trust" (1995, p.26). He also supports other literature, including that of Roy and Dugal (1998) in suggesting that "groups of individuals with similar fundamental characteristics, such as ethnic background, may have an advantage over diverse groups in their ability to create and maintain trusting working relationships" (1998, p.28). Roy and Dugal (1998) advocate cognitive flexibility as the glue to effective group cooperation, over and beyond the factors suggested by McAllister (1995). However, the theme remains the same – relational homogeneity. This view is further reinforced by Williams who argues, "beliefs about trustworthiness are often associated with social group membership" (2001, p. 377) or what Schumacher (2001) refers to as *institution-based trust*. Williams (2001) further claims that where trust development within a group is slow or inhibited, a "critical gap" in cooperation and coordination may occur. This is particularly the case in firms with rapidly changing environments, as may be expected of venture capital-financed companies.

McKnight et al. (1998) investigated various propositions for high initial trust between and among people. They indicate that earlier thought assumed trust in the initial or formative stages of relationships to be low, referring in particular to calculative-based trust research. Further, Holmes (as cited in McKnight et al., 1998) supports the view that trust develops over time and is referred to as knowledge-based trust. This approach has analogy to social exchange theory where familiarity builds trust. Other research cited by these authors (1998), however, contradicts these established theories on trust development. In essence, high initial trust between parties is not uncommon. Clearly this has implications for the entrepreneur/VC relationship, particularly as it relates to the imposition of agency-based mechanisms for security at the start of these relationships. The form of such mechanisms and level of restriction they place upon behaviours may adjust to the level of trust perceived by both parties at the commencement of ventures. VC's in particular use *due diligence* processes prior to venture commitment that reduce information asymmetry and therefore reliance upon trust for engagement decisions. An ironic outcome that may be expected of such a process is a likely increase in cognitive and institutional-based trust from the VC toward the entrepreneur. Whether an inverse relationship between trust and agency risk control mechanisms (venture contract) exists at this point is dubious. Such a relationship is not supported by observations of the venture capital-financing model apparent in New Zealand.

Zand (1972) qualifies the social exchange theory perspective already mentioned, using a "spiral reinforcement model", reflecting the dynamics of trust. This model suggests that the level of trust, strong or weak, is largely dependent on reciprocating behaviours, based on an interpretation of actions by the players. "The level of trust will evolve as the parties interact" (Mayer et al., 1995, p.727). This concept of dynamic interaction is the essence of social exchange theory. Rotter also cites research which indicates that "people who trust others more are also more trustworthy, or cooperative" (1971, p.652). Hence, previous relationships, both personal and professional, can have significant bearing on entry decisions by entrepreneurs and VCs with respect to business relationships. This position is most notable in the due diligence and relational assessment phase of venture capital negotiations. Aside from shoring up a given business model, entrepreneurs and VCs appear also to use this period to assess the trustworthiness, among other traits, of their intended business partner.

Mayer et al. (1995) summarise the antecedents of trustworthiness, a central component of interpersonal trust, from the literature as follows:

- Ability

  "Skills, competencies and characteristics that enable a party to have influence within some specific domain" (p.717).

- Benevolence

  "Benevolence is the extent to which a trustee is believed to want to do good to the trustor, aside from an egocentric profit motive" (p.718).

- Integrity

  "The relationship between integrity and trust involves the trustor's perception that the trustee adheres to a set of principles that the trustor finds acceptable" (p.719).

In a practical sense, two mechanisms are used by both entrepreneurs and VCs to assess the level of trustworthiness in their counterpart. These include firstly the other's personal profile, and secondly the context of the venture relationship. In terms of personal profile, characteristics of ability, benevolence and integrity are generally interpreted by entrepreneurs and VCs using for example, industry reputation, relevant business experience and professional affiliations, equivalent to the prescriptions of institution-based trust.

The second mechanism is context, with its formalised structures, processes and protocols, all mostly dictated by the VC. These mechanisms employed by the VC could be interpreted as signalling their perception of the entrepreneur's level of trustworthiness. More tangibly, they also establish the respective degrees of power held by each party at the outset of the relationship – the VC having greater formal power.

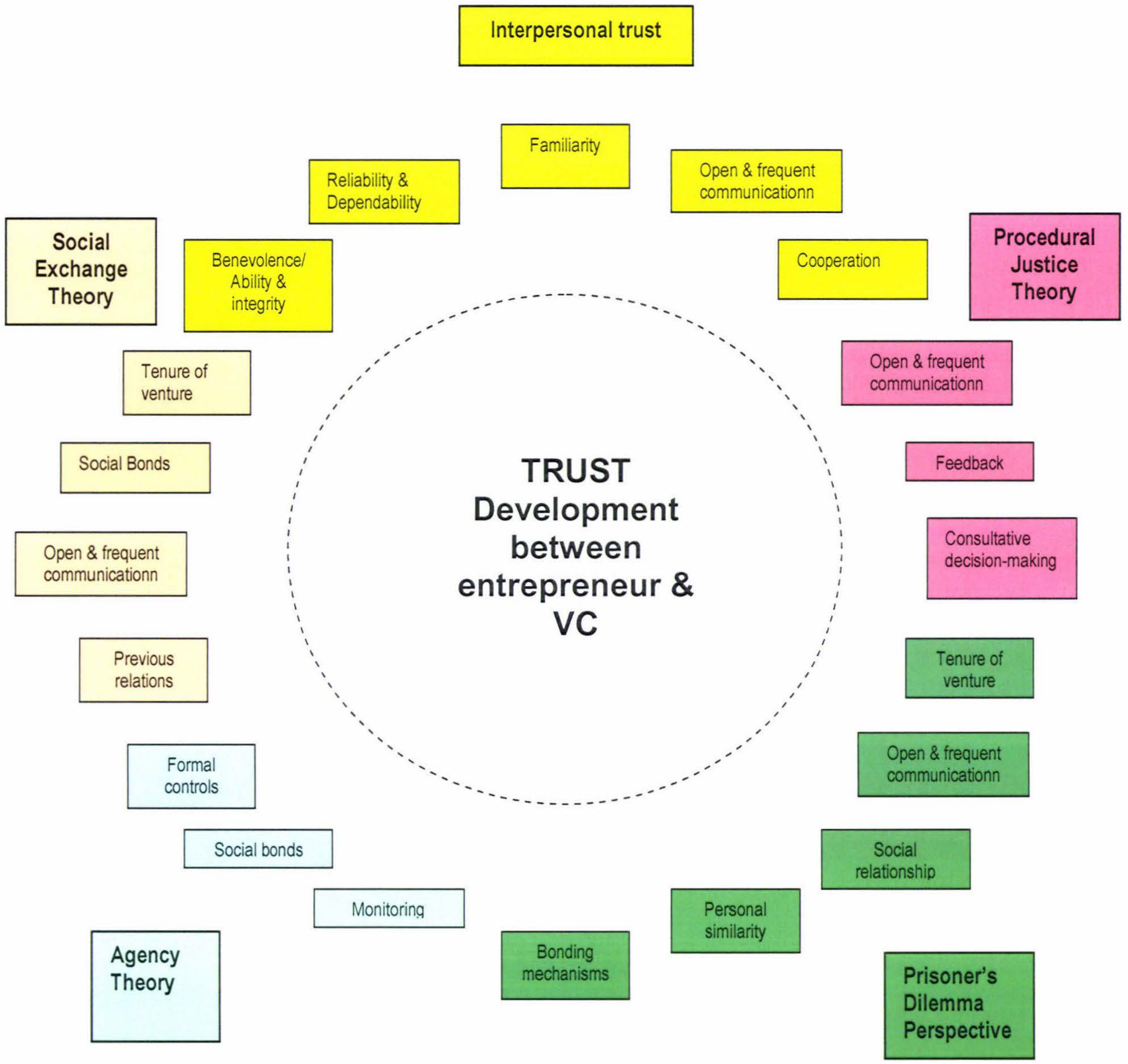
Summarising this chapter, interpretation of the development of trust in venture capital-financing relationships has been enlightened via examination of five theoretical concepts. The theories explored include agency theory, prisoner's dilemma theory, procedural justice theory, social exchange theory and interpersonal trust theory. As graphically illustrated throughout this chapter, individual theories alone do not sufficiently explain the development of trust in relationships. Moreover, particular relationships exist among the five theories, as illustrated in the accompanying *Figures* and indicated throughout this review. Interpersonal trust theory especially appears to have commonality with all five theories as well as its own definitional criteria. These theories, combined, form a theoretical construct which explains the dynamic of trust development in both interpersonal and organisational relationships and which has particular application to the venture capital model.

Figure 2 below represents the trust development construct (conceptual framework) often referred to throughout this research. (Diagrammatical representation of conceptual frameworks is preferable to narratives according to Miles and Huberman, 1994). The construct is comprised of the five significant theories explored in the preceding literature review. Moreover, the diagram identifies the definitional elements for each theory contained in the literature. This schema is colour-coded for visual clarity. In the middle of the schema is a white circle representing the development of trust. The interaction of the theories and their combined explanatory power of trust development presents a complex picture. However, one of the powerful attributes of this thesis is to have crafted a composite of relevant theory with which to better understand the development of trust in venture capital-financing relationships.

Despite some guidance in the literature, there is still much uncertainty about the comparative salience of each theory comprising the construct in their ability to explain trust development in the venture capital-financing context. The arrangement of the theories in a circular fashion about the "trust hub" in Figure 2 deliberately symbolises their initial, un-tested equality of explanatory power. This complex issue is revisited in the "Discussion" chapter of the thesis which seeks to explain the empirical findings using the construct.

The definitional elements of each theory in the construct especially guide later questionnaire development (See Appendix G) but also inform semi-structured interviews also used as a data gathering method in this research.

Figure 2


Interpersonal trust
Familiarity
Reliability & Dependability
Open & frequent communicationn
Social Exchange Theory
Benevolence/ Ability & integrity
Cooperation
Procedural Justice Theory
Tenure of venture
Open & frequent communicationn
Social Bonds
Feedback
TRUST Development between entrepreneur & VC
Open & frequent communicationn
Consultative decision-making
Previous relations
Tenure of venture
Formal controls
Open & frequent communicationn
Social bonds
Social relationship
Monitoring
Personal similarity
Agency Theory
Bonding mechanisms
Prisoner's Dilemma Perspective

PART II:

2. Methodology

2.1 Research Design

The overall design of this research is represented in the following diagram (Figure 3).

Figure 3

Step 1

Explore the relationships of VCs and entrepreneurs through dialogue. Validate the theoretical trust development construct for use in explaining trust development in venture capital relationships.

Method: First round interviews and survey

Step 2

Continue to explore the development of trust within venture capital relationships. What factors and behaviours impact trust development?

Method: semi-structured interviews with VCs and entrepreneurs. Questions guided by questionnaires findings and data coding framework.

Step 3

Analyse the data collected to build an interpretive model of the development of trust within venture capital relationships.

Step 4

Analyse the model of trust development within venture capital relationships for conceptual linkages to trust related theory and the venture capital-financing model itself.

This is a qualitative, mixed method research thesis. Qualitative design, also known as flexible research (Robson, 2002) has evolved from a wide range of intellectual and disciplinary traditions (Mason, 1996). Qualitative research, according to Strauss and Corbin (1990, p.17), "is any kind of research that produces findings not arrived at by statistical procedures or other means of quantification." Mason (1996) states that "qualitative research is grounded in a philosophical position which is broadly "interpretivist" in the sense that it is concerned with how the social world is interpreted, understood, experienced or produced."

The decision to use a qualitative research approach is typically guided by the research problem. "Qualitative methods can be used to uncover and understand what lies behind any phenomenon about which little is yet known" (Strauss and Corbin, 1990, p.19), or "when the objectives of the study demand in-depth insight into a phenomenon" (Ghauri, Gronhaug & Kristianslund, 1995, p.86). This explains the exploratory nature of qualitative research, akin to the current research, which is most appropriate when research variables and their relationships are poorly understood (Strauss and Corbin, 1990) and/or theory are not known or uncertain (Creswell, 1994). These criteria support the decision to use a qualitative approach in this thesis, where there is uncertainty about which variables in the interaction between entrepreneurs, VCs and the financing model are most germane and trust development within these relationships, the phenomenon under scrutiny, is inadequately explained by existing theory. Existing theory provides only a partial and fragmented explanation of the phenomenon, and generally without consideration of the venture capital model. The phenomenon of trust within entrepreneur/VC relationships is generally explained by a collection of partial theories and incomplete concepts.

Three forms of research design in particular are suited to *real world* qualitative research; case studies, ethnographic studies and grounded theory studies (Robson, 2002). The approach used in this research approximates the characteristics of grounded theory though with strong reliance upon a theoretical *roadmap* for data collection and analysis procedures. Robson

(2002, p.458) would characterise this research method as a middle ground between his *template* and *editing* approaches. The latter approach uses a predominantly inductive data analysis and interpretation method with little reliance upon A priori theoretical frameworks for guidance.

Strauss and Corbin (1990, p.24) state, "the grounded theory approach is a qualitative research method that uses a systematic set of procedures to develop an inductively derived grounded theory about a phenomenon." Inductive research is typified by the researcher gathering detailed information and creating categories or themes until a theory or pattern emerges (Creswell, 1994, p.95). Moreover, inductive qualitative research is suited to unfamiliar, excessively complex terrain, where the intention is exploration and description (Denzin and Lincoln, 1994, p.431). The design of qualitative research can range from highly inductive and loose, to tight and focused, relying upon well-delineated constructs (Miles and Huberman, 1994). Grounded theory is most often closely associated with the first approach. However, in this study, the application of a considerable theoretical and conceptual framework for collection, analysis and interpretation of the data suggests a tighter application of grounded theory provisions is more appropriate.

As already stated, this research employs a mixed method approach which, according to Strauss and Corbin (1990), is appropriate when using the grounded theory method of inquiry. Creswell (2003) supports mixed method approaches in qualitative research, coining the expression "sequential transformative strategy" (p.216). This strategy uses two distinct data collection phases where the results of each are integrated during the analysis and interpretation phases. Importantly, this approach relies upon a theoretical perspective to guide the study (Creswell, 1994), a feature of the current research in terms of the trust development construct. Creswell (2003) states that this factor "is more important in guiding the study than the use of methods alone."

The methods of data collection used in this research included interviews and survey questionnaires. Two rounds of interviews were conducted with both entrepreneurs and VCs and a mail survey administered to each group.

The split interview approach used in this research is qualified by Robson (2002) in which he suggests summarising research findings at a midway point in the data collection process. This permits the focusing of latter data collection.

The first round of interviews contributed to this study in two ways. Firstly, they clarified the researcher's understanding of how venture capital actually operates in New Zealand, assisting description of the local venture capital model and empirically supplementing literature of mostly international origin. Also, the interviews generally clarified the role of trust in local venture capital relationships. This contributed to a broad understanding of the research topic and nominally validated relevant theoretical dimensions of trust development as revealed in the previous literature review.

Glaser and Strauss recognise that often initial data collection is a period of researcher familiarisation, during which he/she commences with a "partial framework… designating a few principal or gross features of the structure and processes in the situation that he will study" (1967, p.45). Denzin and Lincoln (1994) distinguish this initial information gathering phase from later phases in terms of the level of data interpretation by the researcher. Initially the level of interpretation should progress from largely descriptive to explanatory.

Inclusion of a questionnaire survey in the overall research design had three objectives. The first objective was to assess the usefulness of each of the five trust development theories for explaining trust development in venture capital relationships using empirical data. Secondly, the questionnaires sought to reveal and/or validate relationships between each of the five theories for relative weightings of predictive accuracy and relevance. This objective largely sought to validate the trust development construct to support later interview data analysis (Step 1 – figure 3).

It was hoped that the results of the questionnaire phase would transform the trust development construct into a practical tool to assist interpretation of research data overall. Thirdly, data collected by the questionnaires was intended to be fed into the design of later stage interviews and also assist interpretation of the research results. The design of the questionnaires relied predominantly on theory ascertained in the literature review and also incorporated knowledge gleaned from first round interview data.

2.2 Research Population

The research population for this project consists of entrepreneurs and VCs who are, or have recently been engaged in venture capital-financing relationships (See Figure 4, p.74 below). Predominantly, other international research concerning venture capital has defined their research populations in terms of VC *organisations* only. As discussed previously however, defining venture capital itself provides a clearer definition of VCs. As a result VCs may be more broadly defined as those who provide venture capital. This includes both individual[7] (private) and organisational investors as previously explained.

Differentiating VCs in the manner described above is important for collecting data as different sampling frames are required. These issues are discussed further in the section on sample design to follow. Separating private from organisational VCs distinguishes two groups of venture capital providers who operationalise their activities in different ways. Private investors typically operate among informal networks and assiduously strive to protect

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[7] Private equity investors

their identities from publicity. VC organisations by comparison, build public reputations on their investment activities and promote their businesses through public media. A way to categorise this distinction between the two types of VC is to describe them as being either:

- above the line (organisational VCs); or
- below the line (private investors).

The "line" in this instance is a metaphor for differentiating publicly visible investment activities from private investment activities. These categories of VC are referred to throughout this chapter.

Compared with other industrialised countries, the organisational VC industry in New Zealand is very small. Contrasting with other international research in the field, a decision was taken in this exercise to use a wide definition of VC to increase the research population size. There were two reasons for this decision:

- Limiting the research population to just the few organisational VCs in New Zealand was expected to reduce the usefulness (breadth and depth) of any data collected.
- The definition of VC used in this research provided justification for including private venture capital investors in the research population.

In summary, the research population in this research is differentiated according to three sub-groups.

1. VCs – *above the line: normally VC organisations* (actively signal and promote their investment activities)
2. VCs – *below the line:* mostly private (individual) investors (utilise private and informal networks for investment activities)
3. Entrepreneurs (individual company owners from venture companies)

A more detailed breakdown of population attributes follows. As this research examines interpersonal relationships, it was crucial to ensure only VCs and entrepreneurs with particular responsibilities and roles were studied. For this reason specific individual qualifying criteria for inclusion in the research population were developed. These criteria are now explained.

2.2.1 VC Qualifying Criteria

For each organisational VC included in the research population, specific individuals needed to be identified to respond to questionnaires and interviews. The individuals of interest were required to be investment managers, a role defined by the following two criteria.

- Holds/held directorship in a venture company
- Holds/held position of main liaison with venture company (Lead VC)

Investment managers are the individuals claiming direct and significant involvement in any venture relationship. They typically engage as the main liaison between their VC organisations and venture companies during financing relationships[8]. This defining criterion is not usually explicit in venture capital research. The term "VC" is routinely left as a broad proxy for the individual. The reader is often left to interpret this connection alone.

By definition, private equity investors are assumed to fulfil both the above criteria. No further explanation is therefore required.

[8] This research does not attempt to match VCs and entrepreneurs to specific ventures. It was not feasible, in the interests of confidentiality and practicality, to identify specific ventures and undertake a matching process for VCs and entrepreneurs who formed specific dyads to these ventures.

2.2.2 Entrepreneur Qualifying Criteria

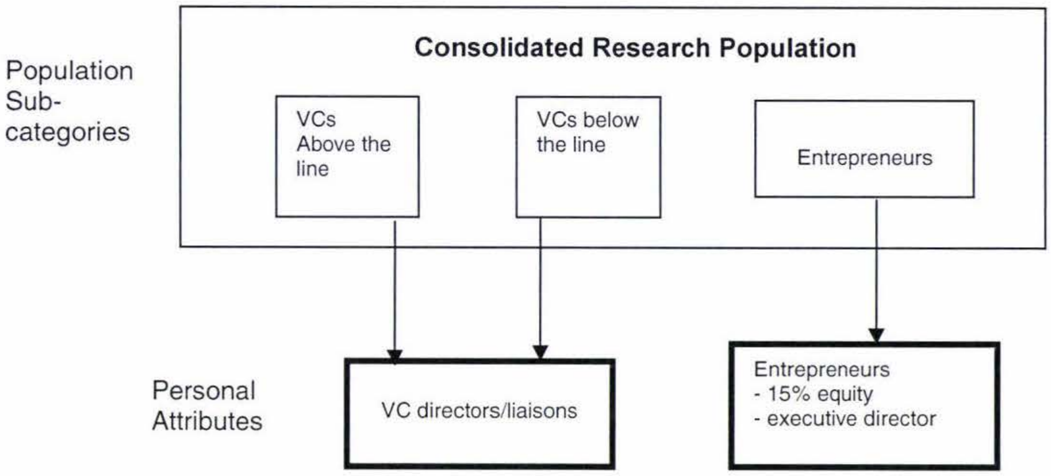
Intuitively, it seems unnecessary to define entrepreneur attributes for this research population. However, as explained above, interpersonal relationships require the research respondents to possess certain responsibilities and hold particular roles for relevance. The literature investigated previously does not precisely define entrepreneurs in terms of these attributes. Therefore, the research population of entrepreneurs used in this study is defined by the following criteria:

- Minimum 15% equity holding in venture
- Directorship held
- Active managerial role held

These criteria required that the respondent from venture companies be an executive director who holds/held no less than 15 percent equity in the venture at commencement of the formal relationship with the VC. Invariably this research participant was expected (and sought) to be an owner/founder of the venture company.

The required threshold of 15 percent equity was qualified as appropriate following discussions with venture capital industry participants. This low equity level was validated on the grounds that substantial dilution of owner equity prior to obtaining venture capital is common. The final two qualifying criteria were that the entrepreneurs held current hands-on management roles and directorships in their ventures.

Figure 4



2.2.3 Population Exclusions

VC attributes include micro business development skills, business networks, international marketing capabilities and governance experience. This is a particular collection of capabilities and competencies required of VCs, as prescribed by the venture capital financing model. This mix of capabilities and competencies is not typical of other types of financial investors. For this reason, the current study excludes from the research population investors whose *primary* or *exclusive* investment activity is *not* venture capital-financing. Accordingly, excluded from this study are banks, law firms and corporations, all of whom are common providers of venture capital in New Zealand and elsewhere.

The decision to exclude other financiers was made for two reasons. Firstly, the capabilities and competencies brought by VCs to financial relationships is a major component of the venture capital model. The model implies that entrepreneurs expect VCs to contribute various competencies and capabilities to their business relationship. Expectations of reliability, commitment and professional competence, for example, impact the relationship in terms of trust. This collection of skills expected of VCs may not be held by other types of financiers. This is expected particularly where venture capital-financing is not an organisation's core business (e.g. law firms, banks, insurance firms). Inclusion of non-exclusive VC financiers in the research population may therefore change the nature of the venture capital model under scrutiny and distort subsequent research findings. Secondly, restricting the research population to exclusively venture capital providers allows clarity of population parameters. For instance, institutional VCs frequently alter their level of activity in venture capital financing, depending on economic and business cycles. An organisation may be a self-professed VC one month/year, and not the next.

2.3 Sample Design (questionnaires & interviews)

Qualitative research commonly uses non-probability sample design methods (Robson, 2002; Creswell, 2003). Non-random research has implications for generalisability or external validity (Robson, 2002; Mason, 1996) of its outcomes, in that making statistical references to the research population is difficult. This does not prevent statements being made by the researcher about correlations between the research sample and the population, but the level of certainty is typically reduced compared to random sampling research methods.

In this research, different sampling methods are used for the collection of data from VCs and entrepreneurs. The disparate nature of the research population, as already profiled, meant that different sampling approaches were necessary to identify and access population members. All sampling undertaken was, however, non-random and purposive.

A sampling frame was only available for above the line VCs. Sampling frames are resources from which smaller samples may be drawn (Mason, 1996). In this study the above the line

VC sampling frame was a reliable list of VCs supplied by an industry source. A sampling frame identifying below the line VCs and entrepreneurs was not available and relied predominantly upon a snowball sampling method (Emory & Cooper, 1991; Page & Meyer, 2000) for access and data collection. Snowball sampling is a data collection method that initially requires the identification of one or more individuals from the population of interest who act as informants to identify further possible respondents, and so on in an iterative, *snowballing* fashion (Robson, 2002).

Below the line VCs were only identified and accessed via the researcher's personal networks. In the event only two such investors were identified and interviewed. Identification of entrepreneurs presented the same problem as that for below the line VCs. It was discovered that often companies in receipt of venture capital are very secretive of the fact and so difficult to identify. A direct approach to companies (and therefore qualifying entrepreneurs) was only possible where they were able to be identified from public media, above the line VC websites and the researcher's personal networks. Alternatively, the questionnaire surveying component of data collection also relied upon above and below the line VCs (once located) to forward questionnaires to their entrepreneur partners. The snowball sampling method was particularly appropriate in this instance.

The research sample comprised thirteen VCs and eight entrepreneurs.

2.4 Data Collection

The New Zealand venture capital-financing industry is notably small, compounded by a high *churn* rate of VCs, moving in and out of the field. In fact on several occasions, introductory telephone calls made by the researcher to VCs from the most current sampling frame of above the line VCs available revealed they no longer engaged in venture capital-financing activities. The smallness of the New Zealand industry is reflected in the number of venture capital-financing *deals* actually undertaken. The Ernst & Young NZ Venture Capital Monitor 2002, for example, identified only 39 deals for the 2001– 2002 year, of which 63 percent in dollar value terms were related to later stage investments. This figure may be presumed to mask multiple deals by individual venture capital organisations, which typically have multiple simultaneous investments. The Ernst & Young quantitative research obtained a response rate of only 18 venture capital firms from the 35 questionnaires distributed.

Difficulties associated with researching the venture capital industry are affirmed by Tyebjee & Bruno who state, "research methodology which relies on the cooperation of venture capitalists in divulging data on their activities is likely to suffer from a high non-response bias and criticisms regarding the generalisability of small sample research" (1984, p.1052). As already noted, identifying and accessing companies in receipt of venture capital also proved difficult in this study, a problem recognised by Huse (1994), hindering data collection. The smallness of the research population and its documented poor response to surveying methods further indicated the appropriateness of the qualitative exploratory method used in this study, where non-representative sampling bias is less of a problem compared to quantitative research methods.

Supporting mixed method research are Miles and Huberman (1994) who present four ways to incorporate quantitative and qualitative research methods. Their (1994, p.41) diagrammatical representation of the method used in this study is reproduced in figure 5 below (p.78). This diagram suggests "alternating the two kinds of data collection, beginning with exploratory fieldwork, leading to the development of quantitative instrumentation, such as a questionnaire. The findings can be further deepened in the next round of qualitative work" (1994, p.41). Surveys can also be part of a qualitative approach, as they are not necessarily quantitative by definition. Accordingly, the results of the surveys in this study contributed qualitatively to question development in the subsequent data collection phase. The approach is supported by Creswell (2003) who argues that integration of mixed research data may occur during any of the three major research phases – data collection, analysis or interpretation (or any combination of these phases).

Figure 5

QUALITATIVE	------------→	QUANTITATIVE	------------→	QUALITATIVE
(exploration)		(questionnaire)		(Deepen, test findings)

Adapted from Miles and Huberman (1994, p.41)

An explanation of the data collection process used in this research is divided into two separate sections. The first, section 2.4.1, provides a detailed account of the questionnaire data collection rationale and process, whereas section 2.4.3 on page 84 explains the interview data collection method used in this study.

2.4.1 Questionnaires

Using questionnaire surveys in this research had three objectives, as already explained. One of these objectives sought to validate the trust development construct devised for this research. While validation of the construct must be considered in relation to the small sample size, the questionnaire results were useful for informing the interview process that followed and assisting interpretation of the research results. The trust development construct was intended as an analytical tool for exploring, understanding and illustrating the dynamic of trust development within venture capital relationships. Recall that five theories comprise the trust development construct. The literature explains the function of each theory using multiple variables. These variables comprise the operational detail, or building blocks, of the trust development construct (Refer Figure 2, p. 65). The identification and application of these variables were well suited to the use of questionnaires for data collection. This is because specific questions could be devised for each theory variable and groups of variables, and standardised responses produced. This, according to Bickman & Rog (1998) and Burns (1996) is an advantage of the questionnaire-based data collection method.

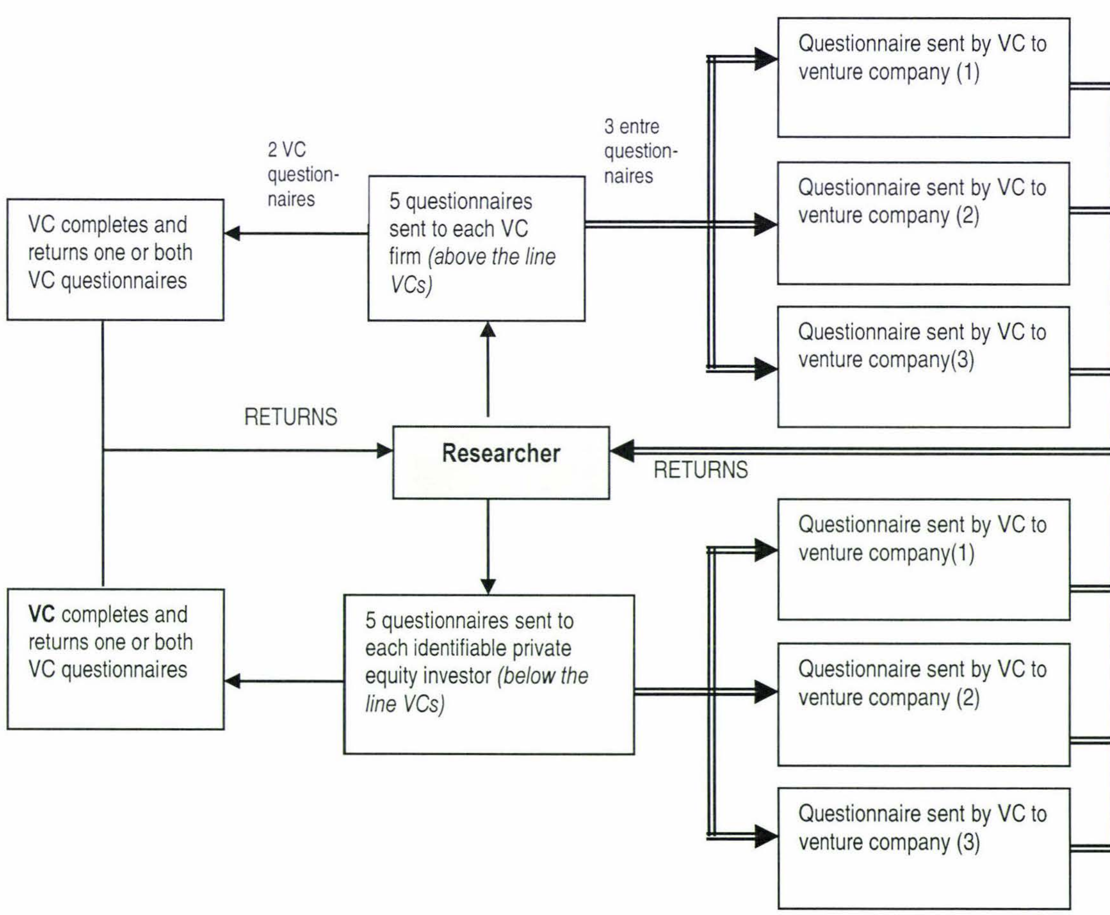
Questionnaires provided a way to test theoretical propositions informing this research. They were seen as largely inappropriate to explore the anticipated variety of behavioural interactions between entrepreneurs and VCs. Interviews were better suited to this task for reasons already explained.

Conducting the questionnaire data collection exercise suffered particularly from constraints in identifying and accessing entrepreneur opinion. An accurate assessment was that VCs would be reluctant to divulge to the researcher the names of companies they had financed, particularly where relationships had soured or under-performed (Tyebjee & Bruno, 1984). Circumvention of this problem was attempted using a snowball sampling method whereby questionnaires were *channelled* through VCs to their often *hidden* partner entrepreneurs. This method was intended to provide complete anonymity to entrepreneurs and the companies they represented. A downside to this approach was limited researcher control over the sampling process.

Despite trawling various publicly available media (including VC websites) to find firms which had utilised venture capital finance, in the great majority of cases the assistance of VCs for questionnaire distribution was required. Of note was that many venture companies listed on VC websites had since ceased operations or moved off-shore, further frustrating the ambitions of this project. Similar to the interview process, snowball sampling was used whereby VCs, above and below the line, who were sent questionnaires were also requested to forward three additional questionnaires to entrepreneurs from companies they had financed. The sampling method is illustrated in the Figure 6 below.

Figure 6 illustrates the channelling process of questionnaires through VCs to entrepreneurs. Of five questionnaires received by each VC, whether above or below the line, three were separately packaged for sending-on to entrepreneurs. The two remaining questionnaires were for completion by the VCs themselves in respect of two separate venture assessments.

Figure 6



The snowball sampling method required assembly of questionnaire packs for sending to VCs. The packs contained two VC questionnaires (see Appendix B) and three envelopes containing questionnaires for entrepreneurs.

Respondent instructions were attached to one of the two VC questionnaires in each pack (See Appendix B). These instructions included details of respondent eligibility for participation and survey completion information. Each pack contained a letter signed by the researcher that explained the nature and purpose of the research, supervisor contact details, participant rights and requested VC participation in the research (See Appendix A). All but two of the packs sent out to VCs included three postage-paid sealed envelopes containing entrepreneur questionnaires. These exclusions were by prior arrangement with the VCs concerned where they were not in a position to forward on entrepreneur questionnaire envelopes. The front of each entrepreneur envelope inside the packs contained the heading "Entrepreneur's questionnaire" and instructions alongside stating, "please address" directed at the VC.

The entrepreneur envelopes each contained a single questionnaire with instructions (See Appendix F), signed introductory letter (See Appendix E) and postage-paid reply envelope. In the case of the entrepreneurs contacted directly by the researcher, they were each sent a single entrepreneur questionnaire, complete with instructions, signed covering letter and postage-paid, return addressed envelope.

Entrepreneur participation in the survey was hindered by two barriers. The first barrier was the entrepreneur's decision about whether or not to participate. The second barrier was reliance upon VCs to forward questionnaires to entrepreneurs in the first place. VCs in most instances were placed in a position of *gatekeeper*. By virtue of the channelling process described, they were handed control over whom to send questionnaires to, if anyone at all. This gatekeeper function is thought to have had a significant impact on entrepreneur questionnaire response rates indicated below.

108 mail questionnaires were forwarded to entrepreneurs, seven of these directly. The other 101 questionnaires were channelled to entrepreneurs via VCs as explained above and illustrated in Figure 6.

In total, 146 questionnaires were sent out to both entrepreneurs and VCs. 38 questionnaires went to VCs. As explained, two identical questionnaires were sent to each VC for completion. VCs were instructed to complete the two questionnaires in respect of two separate ventures. Two venture assessments per VC was sought to increase the volume of data for analysis, particularly given the small VC sampling frame. Minor differences existed between VC and entrepreneur questionnaires to reflect differences in their roles and perspectives.

Thirteen VC and six entrepreneur questionnaires were completed and returned. Five questionnaires were from VCs reporting on a second investment experience. Three VCs returned questionnaires in respect of just a single venture. Therefore, the actual number of VCs responding to the survey was eight (i.e. 5 + 3).

Several observations require mention in light of this response. The unavoidable reliance upon a snowball sampling method for the survey component of this research appears to have been largely unsuccessful in eliciting participation by entrepreneurs in particular. The potential for poor response rates was a recognised risk of this surveying approach. Measures taken to encourage respondent participation in the surveying exercise included direct introductory telephone calls by the researcher to VCs prior to sending questionnaire packs, two follow-up letters to VCs encouraging survey participation (See Appendices C & D), pre-paid postage in all instances and significant attention to questionnaire design to encourage completion, particularly concerning simplicity and length.

The data extracted from the survey exercise contributed to an accumulating mass of information, commencing with the first phase interviews, regarding venture capital relationships and trust. Most importantly, the data received from questionnaires informed and supported the direction of interviews in the final data collection phase and assisted final interpretation of the results, thereby adding value. This is a benefit of the mixed method research approach.

2.4.2 Questionnaire Design

"Empirical research most often implies measurements" (Ghauri et al., 1995, p.42). In phenomenological research it is not the phenomena being measured, but the "properties of the phenomena" (Ghauri & Gronhaug, 2002, p.65). The properties being assessed in the current context are those of the trust phenomenon. Trust concepts were partitioned into respective individual theories in the questionnaires and questions developed to assess their relevant dimensions. Question responses were obtained using mostly ordinal Likert scales, generally coded one through to five. Such scales are effective in eliciting attitudinal information, as is relevant to this qualitative research (Rea & Parker, 1997).

It was intended that the design of the questionnaires would be adapted from existing related survey instruments. However, with the exception of several surveys relating to interpersonal trust, no suitable instruments were available. This absence of applicable survey instruments reinforces previous observations of a dearth of research in this subject area. The uniqueness of the trust development construct devised for this research is further supported by this observation. Two existing questionnaires relating to interpersonal trust were available for adaptation and use in this research. These included Cook and Wall's (1980) "Interpersonal Trust at Work" and Johnson-George and Swap's (1982) "Specific Interpersonal Trust Scale".

This latter instrument also has correlation with a model developed by Rempel, Holmes, & Zanna (1985) which comprises elements of predictability, dependability and faith. Some questions from these instruments were slightly re-worded for context specificity, yet they retained comparability with the previous studies. Selection of these questionnaires was due to their having features commensurate with the theoretical framework of the current research, including ability, benevolence, integrity (Mayer et al., 1995) and reliability (Cook and Wall, 1980).

A detailed account and explanation of the questionnaires' composition is contained in Appendix G.

2.4.3 Interviews

Two phases of interviews were conducted in this study, as previously explained. Key points of difference between interviews in each phase were the scope of information sought and the degree of structure in questions asked. Increased thematic focus in second phase interviews relied upon semi-structured questions, compared to first round interviews which were broader in scope and more loosely structured. These approaches are explained fully below.

Eleven loosely structured, initial interviews were conducted. The purpose of the first phase interviews was three-fold. Firstly, they were intended to indicate the appropriateness of interviewing as a data collection method for this research. Concern was held by the researcher about the willingness of entrepreneurs and VCs to engage in meaningful interviews. Other literature, as previously indicated, recognises VC resistance in particular to research participation. Secondly, prior to commencing the questionnaire surveying component of the study, the interviews were intended to test the research concepts, and to some extent theoretical principles, for empirical relevance. Finally, the interviews were conducted to reveal any issues of relevance not already identified by the researcher that might help to increase the effectiveness of the following data collection activities.

In first round interviews, nine were with VCs, two of which were by telephone. An additional two interviews were conducted with entrepreneurs. The field interviews were arranged directly with the respondents by telephone at which time a brief explanation of the nature of the research and purpose of the interview was provided. This initial contact was in most instances without any prior introduction of the researcher, so effectively *cold calling*. As previously explained, identification of respondents was achieved via a VC sampling frame list, common media, websites and referral. All interviews, except those by telephone, were conducted at the respondents' work premises and lasted from approximately one to one and a quarter hours.

After the questionnaire surveying phase of the project a second round of eight interviews was conducted. The objectives of second round interviews were: 1) to deepen the level of inquiry into the research topic and, 2) incorporate preceding survey results into the interview process. Essentially, the rationale for a second round of interviews was to use an increasing base of knowledge and comprehension of complex topic nuances for a deeper and better informed exploration of the topic. This, Strauss and Corbin (1990) call "theoretical sensitivity". This approach relied upon the interview technique of theoretical sampling, explained below.

The sample group for second phase interviews consisted of four entrepreneurs and four VCs. Five of these closing interviews were with previous interviewees including three VCs and two entrepreneurs. This was a consequence of the substantial time and effort required to identify respondents and obtain their participation in this study in the first place. Subsequent time and resource availability constraints prohibited entirely fresh sampling. All second round interviews were semi-structured and each interview lasted approximately one hour. Of the second phase interviews that revisited previous respondents, permission had already been obtained from the respondents to their being re-contacted. Otherwise, the remaining three interviewees, once identified, were contacted by telephone and interviews requested. As in the first round, all second phase interviews were conducted at respondents' work premises.

A further four consultations relating specifically to technical matters arising in the development of the questionnaires were also conducted. These consultations were required to clarify issues of questionnaire design and information analysis. For example, respondent definitions and data analyses approaches were two areas requiring clarification. In the event consultation was made with two academics and two venture capital industry sources. Qualitative interviewing usually refers to in-depth, semi-structured or loosely structured forms of interviewing which rely on open-ended questions (Mason, 1996; Robson, 2002). Mason suggests that these types of interviews are characterised by a relatively informal style and are a "thematic, topic-centred, biographical or narrative approach that doesn't generally rely upon a structured list of questions, but does have a range of topics, themes or issues to be covered" (1996, p. 38).

Using a conversational (Cooper & Schindler, 1998) approach in the first phase interviews of this thesis, issues relevant to venture capital financing including trust related matters were investigated. These dialogues were steered by the interviewer, taking account of the pool of information and learning that developed throughout the interviewing process. It is particularly effective in face-to-face interviews where one's line of inquiry can be modified in response to information as it is received (Creswell, 2003). Theoretical sampling is a process which exemplifies the concurrent data collection and analysis approach of grounded theory research. It involves analysing data as it is generated to guide further data collection and interpretive categorisation of themes (Mason, 1996). These themes must be substantive to become *categories* during open coding analysis of the data and be subject to theoretical sampling in further interviews (Strauss and Corbin, 1990).

Pre-prepared interviewer guide sheets were used for all interviews (See Appendix H for specimens). For first round interviews these guide sheets were little changed from first to final interview though emerging themes were incorporated into dialogues in a progressive fashion. Second phase interviews were deliberately more focused, seeking deeper understanding of important developing themes that were mostly acquired from first round interviews though also drawing upon questionnaire survey results. This increased focus required that guide sheets were continually updated and modified as new insights came to hand from one interview to the next. Field notes were written onto the guide sheets for all interviews. Promptly after each interview contact summary sheets were typed out using a word processor. These one to two page documents captured the salient information from the interviews using a series of focused questions germane to the emerging research themes (Miles and Huberman, 1994). Interview guide sheets and summary sheets contained the interviewee's name and/or organisation for reference. The summary sheets and interview guide sheets served as the primary information sources for data analysis activity.

None of the respondents requested to see interview their notes, however, on two occasions respondents requested copies of interview guide sheets prior to their interviews.

2.5 Data Analysis Methods

2.5.1 Questionnaires

The apparent key findings in the raw data were extracted from questionnaire results and used to assist both interview design and data analysis. In this way the questionnaires contributed qualitatively to the overall research design and outcomes. Thematic development and data interpretation from both first and second round interviews signalled the more salient information captured by the questionnaire survey results. Generally, data that either apparently reinforced or contradicted both the topic literature and/or interview data was considered the most pertinent. The primary contribution of the survey results was to signpost second phase interviews and assist conceptual interpretation of the overall results. For these reasons analysis of questionnaire data is intertwined with interview data in the results section to follow.

2.5.2 Interviews

Creswell (1994, p.154) explains qualitative data analysis as the process of "reducing voluminous amounts of information into certain patterns, categories or themes and then interpreting this information using some schema."

This project uses an interview data analysis method similar to that prescribed by the grounded theory methodological approach. Whilst the approach provides a sound basis for qualitative research design, Robson (2002, p.193) states that "it is, of course, possible to design a study which incorporates some aspects of [the approach] while ignoring others", such as excessively prescriptive coding procedures.

Data analysis using the grounded theory method, as indeed other methods, relies upon a concurrent, three-part process of data reduction, data display and conclusion drawing/verification (Miles and Huberman, 1994). Data reduction is necessary to make analysis manageable and progress to an increasingly higher level of abstraction. Data display refers to finding methods of organising information to emphasise and illustrate important categories and thematic relationships, whilst conclusion drawing portrays identification of patterns and regularities within the data from which to extract meaning.

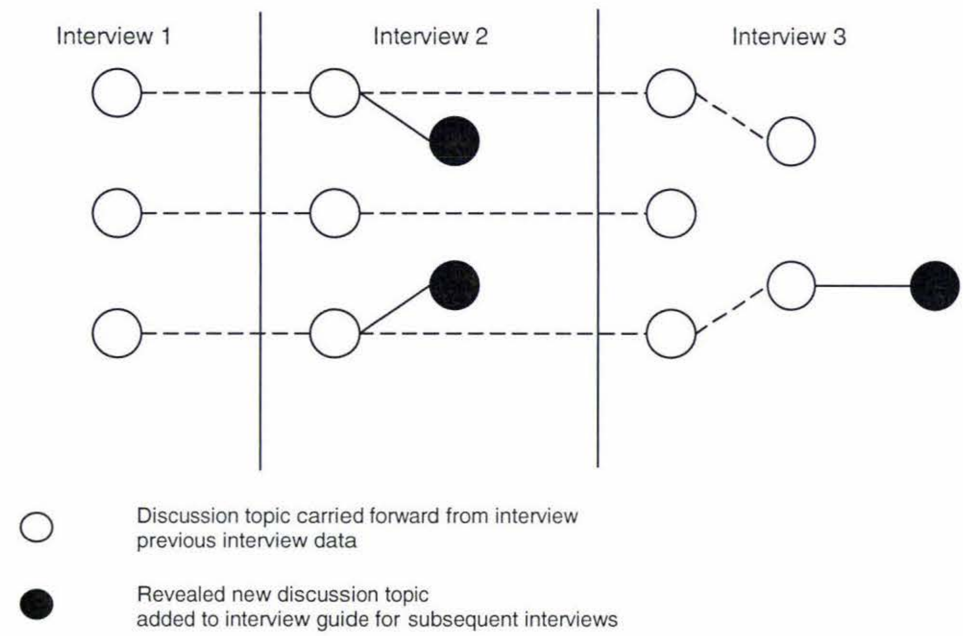
A three-stage process of data analysis (and data reduction) is prescribed by Strauss and Corbin (1990). This requires (Robson, 2002, p.493):

- finding conceptual categories in the data. (*i.e. open coding)*
- finding relationships between these categories *(i.e. axial coding)*; and
- conceptualising and accounting for these relationships by finding core categories. *(i.e.selective coding)*

Strauss and Corbin (1990) stress the nature of the grounded theory method as an iterative process between data collection and analysis via data coding. Open coding is used during the data collection phase of research, which permits an emergence of thematic categories (1990) of importance. This iterative data collection and analysis process is graphically illustrated in Figure 7 below.

Codes are labels generated by the researcher that assign meaning to each piece of data considered relevant to a research project (Miles and Huberman, 1994). Strauss and Corbin explain that open coding is "the part of the analysis that pertains specifically to the naming and categorising of phenomena through close examination of the data" (1990, p.61). "Similar events and incidents are labelled and grouped to form categories" (1990, p.74). Two recurring actions required during the coding process are 1) making comparisons; and 2) asking of questions. This requires that "the data are broken down into discrete parts, closely examined, compared for similarities and differences, and questions are asked about the phenomenon as reflected in the data" (1990).

Figure 7



Thesis Author

Axial coding is the second data coding process and "involves assembling the data in new ways after open coding" (Robson, p.194) and requires consideration of causal and intervening conditions, context and consequences. The third coding process, according to Strauss and Corbin (1990) is selective coding. This final phase of the grounded theory method is prescribed for advanced theory development. An adaptation of the grounded theory method was used for this research as stated, allowing flexibility in its application. As a consequence, selective coding was not applied for the following reasons. The thesis has a significant deductive element, drawn from an expansive theoretical foundation, the sample size was relatively small and an objective was to produce an empirical model of the development of trust in venture capital-financing relationships. Strauss and Corbin (1990) indicate that not all research projects require inclusion of a selective coding phase.

Data analysis conducted in this research commenced by adapting a simple coding framework recommended by Strauss (1987, cited in Miles and Huberman, 1994) and Bogdan and Biklen (1992, cited in Miles and Huberman, 1994). This framework established coding for "setting/context, perspectives, process, relationships and social structure, interactions among actors, strategies and tactics and consequences" (1994, pp.58-61). This adapted framework is not content specific and provided a useful guide for data coding to follow. This approach, according to Miles and Huberman (1994), is a hybrid of A priori and inductive approaches. Also, the collection and analysis of data throughout this project was influenced by the theoretical framework derived from the literature. Robson argues that although such an approach, strictly speaking, is "against the spirit of grounded theory" (2002, p.493) "it is not possible to start a research study without some pre-existing theoretical ideas and assumptions" (2002, p.192).

Guide sheets were synopsised immediately after interviews and summary sheets typed out using a narrative style. Summary sheets then underwent an initial review. During this process codes were handwritten into the left margin beside respective paragraphs and *chunks* of text.

At the end of each interview the summary sheet contents were compared with previous sheets and questions raised about new lines of inquiry, and any perceived information gaps. This was an iterative process which resulted in progressively more codes being accumulated and further modification to interview guide sheets. At the completion of the first round of interviews the summary sheets were again reviewed, codes collated and a first set of conceptual categories identified. At this stage of the data collection/analysis process the main findings from the questionnaire survey results were compared and matched with respective codes and summary sheets marked accordingly.

Using the same data recording process to that in first round interviews, the second round of interviews attempted to deepen the level of inquiry into the research phenomena. In particular, focus was placed on the axial coding process prescribed by the grounded theory method as sufficient data was by then available to develop sound conceptual categories. The data categories developed from earlier analysis, and the search for relationships binding them steered the interviews using the theoretical sampling technique already explained. In addition, examination of the categories required exploration of their properties and dimensions using a question basket approach of "what, why, when, how, where, who", as suggested by Strauss and Corbin (1990, p.73). For these reasons, the semi-structured interview guide sheets underwent greater modification during this round of interviewing.

Finally, conclusion-drawing required integration of the categories to isolate the most germane factors, or "phenomena" to the assist the task of modelling the development of trust within venture capital-financing relationships.

2.6 Ethical Considerations

Miles and Huberman (1990) point to a range of ethical issues that should be contemplated both prior to commencing research and whilst undertaking research. These aspects were considered and addressed for this thesis project, particularly matters concerning honesty, trust and confidentiality. This project was designed and conducted with the on-going supervision of a university supervisor, hence subjected to qualified scrutiny of ethical issues. The project was assessed against Section A of the Massey University human ethics screening assessment form, confirming it as low-risk. Factors contributing to this assessment included the negligible risk of harm to respondents, the informed and voluntary consent of respondents and assurance by the researcher of full respondent privacy and confidentiality.

PART III:

3. Results

3.1 Introduction

This section outlines the results of the data collection and analysis phases previously described. The results are presented in a manner which integrates both the interview and questionnaire survey data to provide fluency and richness. The format chosen to present the results commences with an examination of the conceptual labels and categories developed from the open coding process. Next, results arising from the axial coding (Strauss and Corbin, 1990) phase of the research process are presented with application of the "paradigm model" (1990) (refer Figure 10, p.105 below). A fuller explanation of this process is presented in this section.

3.2 Open Coding

Upon completion of the entire data collection process 194 conceptual labels and twelve conceptual categories had been identified (See Appendix K). The labels were initially grouped under six different headings adapted from the literature as explained in the previous chapter, to provide order from which conceptual categories would be later formed. These headings were setting/context, relationships, interaction among actors, strategies and tactics, consequences and traits.

This section firstly presents a brief explanation of the relationship between the conceptual labels developed from the data and trust. Secondly, to explain the open coding process used in this research, examples of data collected and their analyses are presented. This is done by initially focusing on two arbitrarily selected categories of the twelve developed. Respondent quotations are included to help illustrate the category development process.

Label development is the first step of the data analysis process and requires identification of abstract titles for empirical observations. Labels may arise from specific statements or groups of related statements or observations and are the product of "conceptualising the data" (Strauss & Corbin, 1990, p.63). The twelve categories created were derived by identifying conceptual labels with similar underlying themes and grouping them under common category titles. Most of the conceptual labels and categories arising from the data collection process do not explicitly refer to the development of trust. But then they didn't have to. Rather, they illustrate a range of behaviours and attitudes of similar meaning to existing theoretical variables which define and explain trust. This was a positive outcome of the process which avoided simply restating the theoretical construct upon which most interviews, and certainly the questionnaires, were predominantly based. This process also reduced the likelihood that the researcher's findings were inevitable.

As the interviewing process progressed it became apparent that the language of the trust development construct being used to guide the questioning was being usurped by the conceptual labels and categories being developed. An initial concern of this development was anticipated difficulty of reconciling the two streams of information at a later stage to explain trust development within venture capital relationships. However, it became increasingly apparent that the conceptual configuration of the data was simply a different lens through which trust and its development were being observed and explained. For example, the conceptual labels INFINT (informal interaction) and SIMVAL (similar values) under the coding framework heading of "Relationships" are observations indirectly related to the trust construct variables "social bonds", "familiarity" and "social relationship" of social exchange theory, interpersonal trust theory and prisoner's dilemma respectively. In fact the theoretical framework and empirically derived concepts were quite complementary. So although the initial framing of questions relied heavily upon the theoretical framework developed for this research, the focus became increasingly on the concepts being generated by the data themselves – as with the inductive process of grounded theory method.

Two categories developed from the data will be illustrated below as examples of the analysis process. The first is *Entrepreneur reaction* (Refer Figure 10 – bottom row).

Fourteen conceptual labels were eventually grouped under the category of *Entrepreneur reaction*. *Entrepreneur reaction* surfaced as one of the more intuitive categories due to the stimulus-response interaction between entrepreneurs and VCs. This is no surprise given their being locked in a perpetual cycle of reacting to each other's behaviours and actions, hence a second complementary category of *VC reaction* also being established. All 14 of the conceptual labels grouped together under this category reflect an entrepreneur reaction that is either perceptual or emotive, though often the latter is a consequence of the former. For example, the label VCVAL relates to the entrepreneur's perception of value contributed to the venture by the VC.

> For the first eight months they (VCs) did nothing much to help the company. It was only when things started to deteriorate that they began showing interest. By then the situation was pretty bad because we were unhappy.
>
> (interview with entrepreneur "A"[9], 2003)

---

[9] Quotations included in the results are assigned a respondent identifier (A, B, C, etc) to differentiate among them. Where several quotes included in the text have the same identifier they have been sourced from the same respondent. The quotations arbitrarily commence with respondent A for convenience only.

A similar theme appears under other categories, though usually shaped a little differently. For instance, a conceptual label under the category *Expectations* is VCEXP. This refers to the entrepreneurs expectation of the VC's level of expertise. An example of emotive entrepreneur reaction includes ENTRANGER or entrepreneur anger toward VCs based on a negative experience, as apparent in the quotation above.

Another label concept was derived from VC interviews and again has similar connotations to other labels developed and applied to other categories. This concept was labelled PRAGEMO which refers to pragmatism over emotion. On several occasions VCs mentioned that entrepreneurs reacted to problems in an emotional rather than pragmatic way, which was detrimental to finding effective solutions and usually destructive to the relationship because pride and/or ego created barriers to understanding and compromise.

> Sometimes these guys (entrepreneurs) don't realise that things have to change. It's nothing personal - just good business. They get caught up in thinking we're doing things against them, when the decisions we take are about good business. It's not about trying to push people around.
>
> (interview with VC "A", 2003)

Another discovery from one interview was entrepreneur regret at not having been more assertive with their VC at the time of a problem or having been unable to find a solution to a previous problem – illustrated by the quotation below. This concept label was titled REGRET.

> I should have taken a firmer stand six months ago. When they decided to do things their way, they walked all over us.
>
> (interview with entrepreneur "B", 2003)

Arising from the coding process was the discovery of four properties associated with the category *Entrepreneur reaction*. These included accusation, resentment, frustration and emotion. Category properties are obtained by bundling the conceptual labels into a basket and identifying common themes at an even higher level of abstraction. The four properties in this instance capture the essence of entrepreneur reaction to developments within their relationships. Of note is that the properties identified carry negative connotations and an air of externalising problems - specifically, externalisation of negative emotion directed at VCs. Interviews further revealed the property dimensions, again in keeping with process prescriptions of the grounded theory method. Referring to Appendix K, the dimensions established for each property were either continuums of measurement or dyadic pairs. For example, the property *accusation* was assessed in terms of whether it was explicit or implicit (i.e. a dyadic pair of response options). Explicit accusations were interview statements of blame-casting by the interviewee against their investment partner. Implicit accusations were noted as subtle innuendo or implication of blame toward the other. This dimension alludes to the level of openness in communication between the parties – a determinant of trust development.

Resentment is another property of *Entrepreneur reaction.* The dimensions of this property range from high to low resentment (i.e. a continuum of response options). A discovery in attempting to assess this property during interviews was that entrepreneur resentment toward their VC may fluctuate throughout the term of the relationship or spike in response to specific occurrences. To overcome this time-related problem where resentment was revealed in interviews, an overall score of high, medium or low resentment was recorded using an overall impression of the respondent's attitude. Indicators of resentment during interviews typically had aspects of fault finding and blame casting in the words of the interviewees, often structured in the form of – *If X had done Y, then Z would (wouldn't) have occurred.* (With Z typically being an undesirable outcome).

They (VC) just decided they wanted out and basically sold the company from beneath us. There was no compromise and everybody was suddenly only interested in saving their own necks.

(interview with entrepreneur "B", 2003)

Second round interviews, as previously discussed, were informed by data captured during the questionnaire phase of the data collection process. A link was made and asserted between some aspects of questionnaire and interview data regarding the *Entrepreneur reaction* category described above. For instance, much of the accusation and resentment expressed by both entrepreneurs and VCs seemed directly related to venture performance, as reflected in questionnaire results below.

Figure 8

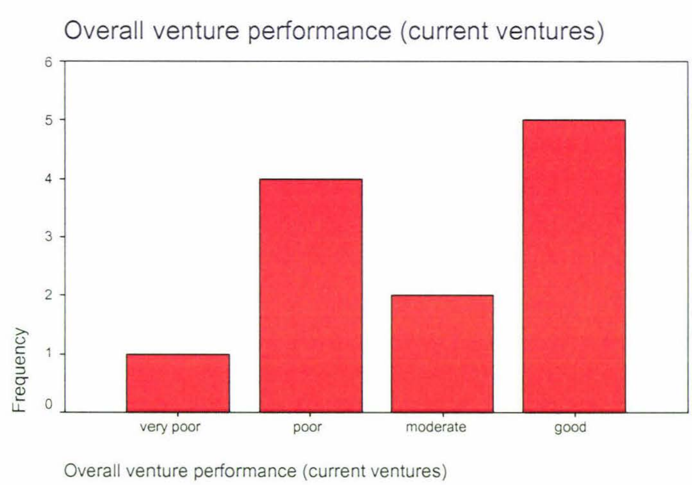
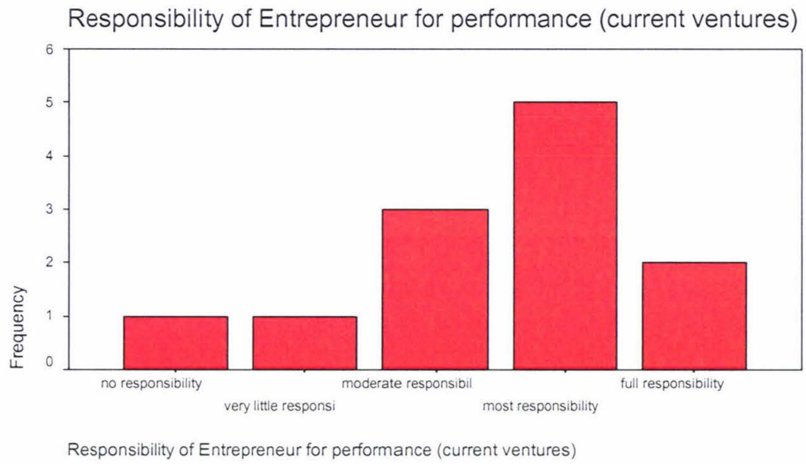


Figure 9



The frequency bar chart in Figure 8 above indicates that of 12 current ventures VCs reported that 7 had moderate to very poor performance[10]. Also, in 7 ventures VCs accord most to full responsibility for performance results to the entrepreneur (Figure 9). Although not apparent from the tables, the original questionnaires reveal that of these 7 ventures 4 entrepreneurs are credited by VCs with most or full responsibility for poor or very poor venture performance. Inversely, of ventures performing either moderately or good, 3 entrepreneurs were credited by VCs with moderate to no responsibility for this result. Only 4 entrepreneurs from good performing ventures were credited by VCs as mostly or moderately responsible for the performance outcomes. Interestingly none of the respondents indicated their ventures to have excellent performance. Entrepreneurs were more favourable in their responses to the same questions (Tables 1 & 2 below) indicating that for ventures having good to excellent performance VCs carried moderate to most VC responsibility.

[10] Venture performance assessment was entirely perception-based and used no financial measures. Relativity of assessments was not important because perceptions of performance impact the relationship between entrepreneur and VC as might financial measures.

Table 1

Entrepreneur perceptions of overall present venture performance

Performance	Frequency	Percent	Cumulative Percent
Good	4	66.7	66.7
Excellent	2	33.3	100.0
Total	6	100.0	

Table 2

Entrepreneur claims of VC responsibility for venture performance

Level of Responsibility	Frequency	Percent	Cumulative percent
Moderately responsibility	5	83.3	83.3
Most responsibility	1	16.7	100.0
Total	6	100.0	100.0

A second example category is entitled *Traits* (See Figure 10 – 3rd row). This category also comprises fourteen conceptual labels established throughout the data collection process. Examples of the labels created include *mission impossible* (coded M/I) and *VC world* (coded VCWORLD). The conceptual explanation set out in Appendix K for M/I is that entrepreneurs and VCs are to a large extent different *animals*. This appears less so regarding private equity investors who often have had experience owning and operating their own businesses. This is reflected in the following statement which is somewhat disparaging toward the interviewee's larger VC organisation counterparts.

> A lot of the big guys (above the line VCs) have never run their own business. I don't see it as a good thing because they usually have no idea of what owning a business is all about. In my experience that's when you get problems.
>
> (interview with VC "B", 2003)

The M/I label was applied whenever it was noted in interviews that VCs and entrepreneurs, broadly speaking, struggled to comprehend the motives and plights of the other. The label name was created to imply that such an apparent incongruence in traits creates a very difficult situation between entrepreneurs and VCs in trying to reconcile their differences, particularly in times of turmoil.

The second example of a conceptual label from the *Traits* category is VCWORLD. This label is related to M/I except focuses on a reason for the incongruence between VCs (particularly those above the line) and entrepreneurs rather than outcomes of the intrinsic problem. The explanation accompanying the label (Appendix K) indicates that above the line VCs have difficulty connecting with the entrepreneurs they finance, ostensibly because of the backgrounds, whether professional, experiential, or social, of the individuals involved.

Five properties were deduced from the collection of conceptual labels for the *traits* category. These include partner fit, partner behaviour, partner ability, intuition and VC compassion. Several of these properties were supported in their findings by the questionnaire results. For example, entrepreneurs commonly assess their VC's abilities in terms of their experience of having personally run their own businesses (Table 3). Entrepreneurs, it appears, commonly think that VCs cannot comprehend the trials and tribulations they experience without having experienced running their own business – as in the quote above. In the absence of such experience, the degree of respect by entrepreneurs toward VCs is apparently lower. Also, entrepreneur confidence in the *ability* of the VC to deliver non-financial contributions to their ventures impacts the former's assessment of trustworthiness in the latter (Mayer et al., 1995). Indicators of VC ability also include personal attributes, work histories, industry experience and professional and academic qualifications, all related to the concept of institution-based trust in the literature (Rousseau, 1998). VC credibility, in the eyes of entrepreneurs is therefore impacted by factors of respect and perceptions of ability.

Table 3

VC has personal experience running a business

Response	Frequency	Percent	Cumulative Percent
Yes	9	69.2	69.2
No	4	30.8	100.0
Total	13	100.0	

Conversely, VCs are commonly critical of the abilities of entrepreneurs, as revealed in Table 4 below. As is indicated, in only three of all ventures referred to do VCs believe the business competence of entrepreneurs to be good or excellent. This leaves 10 ventures in which VCs rate entrepreneur competence as moderate to poor, with five rated as poor. These low perceptions of task ability/competence, according to the literature may impact trust development throughout the course of the venture lifecycle. The consequences of such perceptions may be closer VC monitoring, stricter control structures and less equitable contractual design for example. This data is closely related to questionnaire results in Table 5. Here VCs indicate that of 13 ventures, almost half consisted of entrepreneurs who they believed were either mostly reliant or completely reliant upon them for running their ventures effectively. Logically, where VCs rate their venture entrepreneurs as having low levels of business competence, expectations held by VCs about entrepreneur reliance upon them for venture success should be higher. This appears to be supported by the data here.

Table 4

VC's perception of entrepreneur's managerial competence

Entrepreneur competence	Frequency	Percent	Cumulative percent
very poor	2	15.4	15.4
poor	5	38.5	53.8
moderate	3	23.1	76.9
good	2	15.4	92.3
excellent	1	7.7	100.0
total	13	100.0	

Table 5

VC perception of entrepreneur's reliance on their input for venture success

Level of reliance	Frequency	Percent	Cumulative percent
Completely reliant	2	15.4	15.4
Mostly reliant	4	30.8	46.2
Somewhat reliant	5	38.5	84.6
Not reliant	1	7.7	92.3
Too difficult to determine	1	7.7	100.0
total	13	100.0	

3.3 Axial Coding

Figure 10 below diagrammatically represents the approach to Axial Coding used in this study as prescribed by the grounded theory method and application of the paradigm model (Strauss & Corbin, 1990). Indicated are the various categories revealed through analysis during the open coding process explained thus far. The results described in this section use the paradigm model to identify the relationships between and among the categories

Existing categories are delineated into main categories (phenomenon) and sub sub-categories. The Paradigm Model then identifies their interwoven relationships using a stepwise process, as represented in Figure 10. The first two steps establish the ***phenomena*** to be explained and their *causal* conditions. Phenomena are the "central ideas, events, happenings, incidents about which a set of actions or interactions are directed at managing, handling, or to which the set of actions is related" (Strauss & Corbin, 1990). They are the ideas central to the data and revealed by asking questions such as, "what is the action/interaction all about?" (1990, p.100). Next, ***action strategies*** used by the subjects are studied whilst taking into consideration the impact of ***intervening conditions***. The final stage in this model is identification of ***consequences*** arising from the actions of subjects. Using this model, hypothesised relationships between categories and sub-categories rely upon re-visiting the empirical data for supporting or contradictory incidents. This is achieved by "asking questions and making comparisons" in relation to the data (Strauss and Corbin, 1990, p.114). Two worked examples of this process using the paradigm model can be found in Appendix L of this thesis.

Axial coding revealed three categories (phenomena) (Strauss & Corbin, 1990) - *Expectations, Relationship, Trust development* (Refer Figure 10 – 2nd row), nine sub-categories and the relationships among them using associated properties and dimensions. Completing the rest of this section is a systematic examination of the data using the paradigm model, as discussed, to illustrate the key research results.

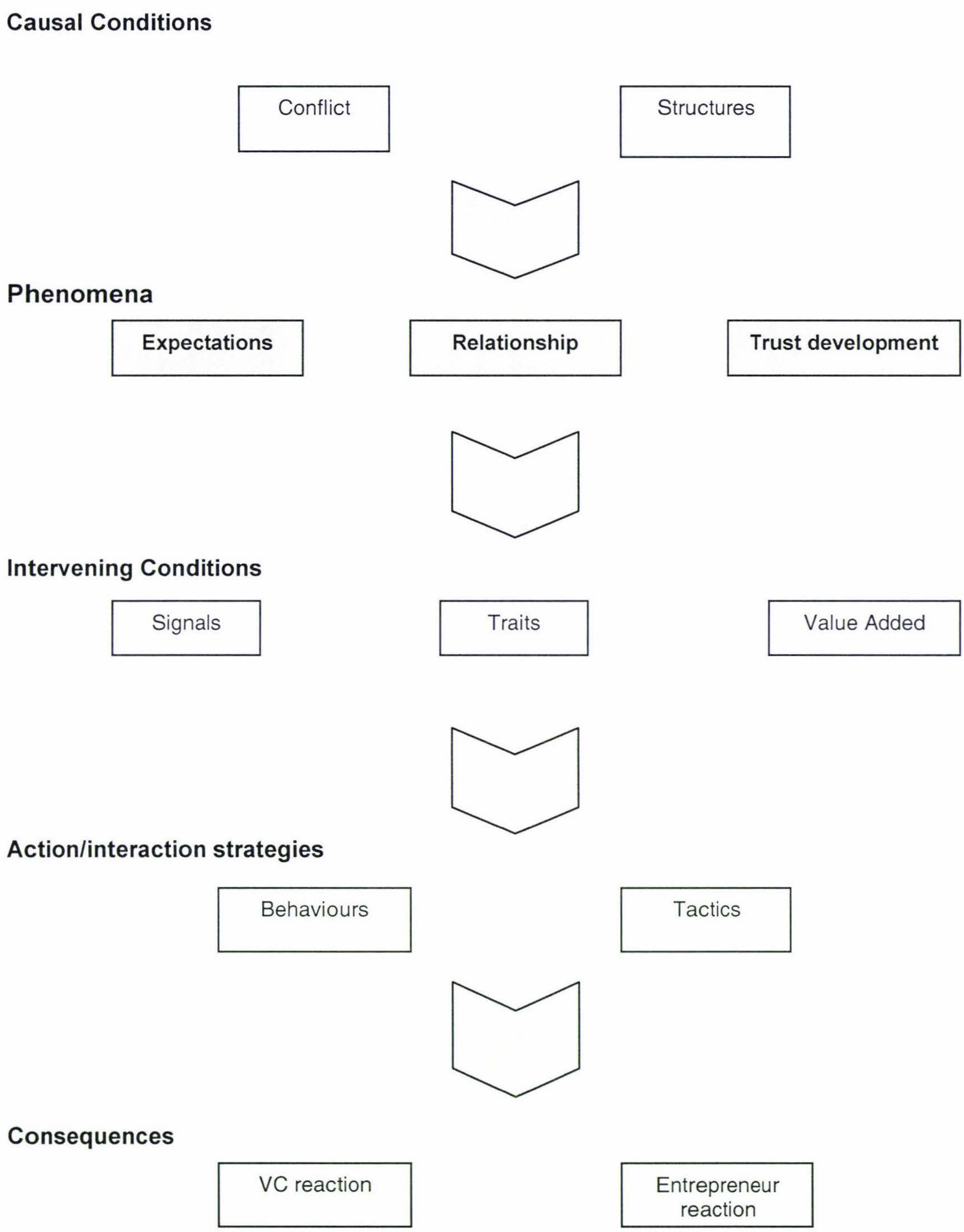
3.3.1 Expectations, Relationship and Trust Development

Analysis of the data revealed the following categories and their properties (Refer Appendix K):

- *Expectations* category - seven properties. These include business outcomes, conflict, VC contribution, cooperation, partner ability, partner control and trust.
- *Relationship* category – six properties. These include character match, emotion, commitment, deterioration, VC dominance and solutions.
- *Trust development* category – six properties. These include intentions, personalities, cooperative behaviours, board processes, manageability and contract.

"Properties are attributes or characteristics of categories" (Stauss & Corbin, 1990, p.70) that are derived during the open coding process. They may be observed in individual pieces of

Figure 10



Causal Conditions
Conflict
Structures
Phenomena
Expectations
Relationship
Trust development
Intervening Conditions
Signals
Traits
Value Added
Action/interaction strategies
Behaviours
Tactics
Consequences
VC reaction
Entrepreneur reaction

data or groups of data (1990). Both approaches were employed in this research and included a method of grouping conceptual labels to help identify salient properties.

A recurring theme throughout the data gathering and analysis process was that expectations often underpinned the perceptions of trust by both entrepreneurs and VCs. Ultimately, it appears that the consequences of relationships failing, meeting or exceeding expectations are influenced by the action strategies of subjects who react to contextual factors and intervening conditions. Not surprisingly, expectations also contribute to shaping the relationship and the development of trust.

Expectations are phenomena derived from individual traits, previous experiences and other variables that are external to the venture capital financing model and entrepreneur/VC relationship. These antecedents of expectations may be assumed to be in addition to those shaped by interactions within the relationship itself. Furthermore, expectations may therefore influence and be influenced by participant actions.

Referring to Figure 10, two causal conditions, *conflict* and *structures*, shape the three phenomena of *expectations*, *relationship* and *trust development*. Entrepreneur and VC action strategies are defined by their behaviours and tactics, whilst influenced by the intervening conditions of signals, traits and value added, as deduced from the data by applying the Paradigm Model. Finally, entrepreneur and VC reactions are the consequences of interaction among these variables.

When venture capital relationships commence, they were shown in Chapter One to have particular features that partly comprise the venture capital-financing model. It is useful to review these features to illustrate the impact of *conflict* and *structures* upon all three phenomena comprising entrepreneur/VC relationships.

Contractual conditions are generally perceived as fair and reasonable by both entrepreneurs and VCs (refer Tables 6 & 7, p.107), despite the former also commonly acknowledging their belief that the VC has greater control, as revealed in the following representative interview comment.

> At the end of the day the person with the money has control. That's them (VC) of course.
>
> (interview with entrepreneur "C", 2003)

Table 6

Entrepreneur believes the contract between them and the VC is fair and reasonable

Response	Frequency	Percent
Agree	4	66.7
Strongly agree	2	33.3
Total	6	

Table 7

VC believes the contract between them & the entrepreneur is fair and reasonable

Response	Frequency	Percent
Strongly disagree	1	7.7
Agree	8	61.5
Strongly agree	4	30.8
Total	13	100.0

Perceiving themselves to occupy a weaker structural starting position in the relationship to VCs, entrepreneurs appear to place greater reliance upon trust as a means of self-assurance in the integrity and efficacy of their VCs future behaviour and decisions (refer Table 8).

Table 8

Entrepreneur claims of the level of trust at the start of the venture

Response	Frequency	Percent
Moderate	1	16.7
Strong	2	33.3
Very strong	3	50.0
Total	6	100.0

It was difficult to identify a relationship in the data between acceptable levels of risk and trust for both entrepreneurs and VCs at the commencement of ventures. For VCs each venture is assessed along a range of criteria and if an investment exceeds a given risk threshold the deal does not proceed. The closest approximation to an assessment of trust in prospective entrepreneurs by VCs appears informally conducted, as represented by the following quotation.

> It's important we can sit down to a beer with the guy (entrepreneur) and just chat and get along generally. Without that, what's the point?
>
> (interview with VC "C", 2003)

Despite the apparently informal nature of such assessments, VCs regularly stated in interviews that being able to trust their prospective entrepreneurs was a consideration in their pre-investment appraisal.

> We have to know we can trust somebody before we invest with them, but this is just one aspect of the investment decision-making process.
>
> (interview with VC "C", 2003)

Governance arrangements are typically agreed at the commencement of ventures which effectively signals monitoring and control arrangements by VCs over their investments. This typically includes VC participation on the company board, specific voting and veto rights and importantly, the right to replace underperforming chief executives. These factors present a formal framework of expectations about how the parties to the venture would interact and obtain formal resolution to problems, and also indicate the intended level of control exerted over the venture by the VC.

As has already been indicated, VCs normally contribute management expertise and marketing knowledge, provide access to networks and raise capital for the ventures they finance. Interviews revealed that of all the entrepreneur expectations most commonly breached, failure by VCs to deliver business expertise and connections was the most typical catalyst to relationship deterioration.

> They (VCs) talk it up as though they have all the answers and can take your company to the next level. They've failed to deliver on many things, in particular developing offshore markets. Marketing offshore was absolutely fundamental to making the company fly.
>
> (interview with entrepreneur "C", 2003)

A logical link exists between VC contribution to the venture and expectations by entrepreneurs of their general business ability. On the whole entrepreneurs were less likely to be critical of the latter, explaining poor contribution outcomes as mostly due to disinterest or inadequate attention by the VC to the firm's needs. Conversely, VC's routinely held strong reservations about the general level of managerial acumen possessed by entrepreneurs, as revealed in interviews and the questionnaire results (see Table 4, p.102 above).

> It's a common story in that you get a business with a great product or service but the guy running the place has limited business skills. This is why it's not uncommon to have to replace him as the CE somewhere down the track... of course they fight it till the end.
>
> (interview with VC "D", 2003)

Returning to the causal conditions of conflict and structures and their impact upon the three phenomena of *expectations*, *relationship* and *trust development*, it was generally apparent from the data that VCs and entrepreneurs, upon commencing a venture relationship, are largely satisfied with most aspects of the deal arrangements including formal structures and expectations of performance and partner contribution. Importantly, every entrepreneur respondent was adamant that they would not have entered a venture relationship they viewed as severely balanced in the favour of the VC.

The results show that the three phenomena are most sensitive to the properties of *interpersonal* [conflict], *remedies*, *venture performance, monitoring and control* from the "Causal Conditions" *conflict* and *structures*. This is an intuitively appropriate outcome for the following reasons.

Firstly, none of the respondents during interviews expected the journey throughout the term of a venture engagement to be entirely plain sailing. So an expectation of some level of conflict, by some cause and at some level is generally held by entrepreneurs and VCs. The impact of conflict upon the phenomenon *expectations* is determined by the effectiveness of any remedies pursued by the parties, as assessed by both parties in terms of venture performance and overall fairness.

The category *relationship* is impacted by *conflict* and *structures* in a different way. Where venture performance degenerates or interpersonal relationships become strained, *relationship* properties of *emotion*, *VC dominance* and *solutions* are particularly germane. According to the data, often the solutions VCs impose on a severely deteriorating venture rely on their contractually and financially dominant positions to exert influence. If the reaction to these actions by the entrepreneur is emotive rather than pragmatic then interpersonal relations commonly deteriorate further. Hence, the *remedies* used to rescue deteriorating ventures and the level of individual pragmatism displayed to find resolutions have significant implications on the development of trust.

The sudden imposition of a structural remedy, by way of contractual recourse for example, also has a negative impact on *trust development*. Illustrating such a result is the following entrepreneur statement:

> We were probably a bit naïve in not fully understanding every detail of the finance agreement. When they (VC) saw an opportunity to reap significant financial gain by playing with the share structure recently it was very damaging to the relationship we'd developed. They were doing what they wanted to do because they could, without the slightest apparent concern for us or the company. The only thing that stopped them proceeding was our finding a legal resolution. The trust took a big hit from that.
>
> (interview with entrepreneur "D", 2003)

As already noted, although entrepreneurs and VCs may be quite content with the state of affairs commencing a venture relationship, this provides little surety for the future of the relationship, as indicated in the following two tables.

Table 9

Entrepreneur's perception of change in the level of trust since start of venture

Level of trust	Frequency	Percent
Decreased	1	16.7
Not changed	1	16.7
Increased	3	50.0
Greatly increased	1	16.7
total	6	100

Table 10

VC's perception of change in the level of trust since start of venture

Level of trust	Frequency	Percent
Greatly decreased	4	30.8
Decreased	2	15.4
Not changed	3	23.1
Increased	4	30.8
total	13	100.0

The paradigm model proposes that *causal conditions* give rise to *phenomena* around the topic of enquiry. Consequently the nature of the phenomena arising from the causal conditions significantly influences actor behaviour, referred to as *action strategies* (See Figure 10 – 4th row). The Model requires that *action strategies* and *intervening conditions* must be assessed together before final *consequences* can be determined (Strauss & Corbin, 1990).

When positive expectations by entrepreneurs and VCs at the commencement of ventures (as is typical) are undermined by interpersonal conflict, a deteriorating relationship, destructive remedies, poor venture performance, dubious partner intentions, diminishing cooperation, confrontational board processes and eroding trust, not surprisingly the action strategies employed by entrepreneurs and VCs, play an important role in final outcomes for the relationship. However, the results of the research suggest that action strategies used are regularly ineffectual in recovering a venture from a downward slide in relationships, as illustrated by the following interview comments.

> Whenever we get to the stage of having to penalise the entrepreneur the relationship is usually pretty bleak anyway. In instances of entrepreneur equity dilution for example, failure to meet performance targets can eventually erode their ownership in the company, encouraging them to walk away completely, out of disinterest and disgust.
>
> (interview with VC "A", 2003)

> Things got really bad during board meetings. The politicking takes over and everyone's pointing the finger at everyone else. It becomes hopeless. Nobody likes accepting responsibility for things going wrong.
>
> (interview with entrepreneur "A", 2003)

Based on the data, signals, personal traits and the ability of individuals to contribute value to a venture modify the actions strategies selected in venture capital relationships. Although for trust to develop in relationships requires cooperation, among other things, the results indicate that where relationships break down behaviours become destructive and blaming behaviour is common. To a large extent these outcomes appear more typical of dissatisfied entrepreneurs rather than VCs who can resort to imposing greater formal control, particularly at the company board level. These action strategies however, are influenced by the various intervening variables. For example, depending on the level of communication between parties, *signals* play a role in informing how VCs and entrepreneurs should react to particular developments. Most of the time signals are very explicit, such as the VC failing to contribute to a venture, or an entrepreneur becoming increasingly reclusive when a venture is deteriorating.

> They (entrepreneurs) become pretty quiet when the problems start coming. It's often hard for us to be completely on top of what's happening in a firm because we rely a lot on information from the CE, despite sitting on the board.
>
> (interview with VC "E", 2003)

The behaviours and tactics used by entrepreneurs and VCs are also impacted by their individual traits. Venture screening does not always present an entirely accurate representation of entrepreneurs in particular, in terms of their reaction under stress or how cooperative they may be later in ventures. The following VC comment captures this aspect.

> I rely a lot on trust to determine how an investment should be governed, but of course everyone is on their best behaviour at the start of a venture. So this may be a misleading indicator.
>
> (Interview with VC "F", 2003)

In a similar vein, individuals' skill to resolve conflict and repair damaged trust has a role to play in the behaviours and tactics used in relationships. The results indicate that VCs do not have trained understanding of interpersonal conflict and call upon intuition and personal ability to deal with difficult interpersonal matters in their relationships. This has significant implications for the action strategies employed by VCs especially. The results indicate that VCs understand the risks of implementing formal control mechanisms to resolve relationship problems. Yet the use or threat of use of such solutions in venture capital relationships seems remarkably high, as indicated in the following table from VC questionnaires (Table 11).

Table 11

VC claims either they or entrepreneur have threatened or used legal action to resolve venture conflict

Threat/use of legal remedy	Frequency	Percent
Yes	5	38.5
No	8	61.5
Total	13	100.0

Action strategies used by VCs in times of turmoil include those outlined by a VC in the following statement.

> In my experience the key influence is through board control and monitoring of [the] CEO and his/her performance. In times of crisis information on company performance and position often becomes sparse and late. Therefore the board should meet more regularly, deadlines agreed for information action plans or agreed milestones need to be adhered to and followed up on. It may be appropriate to get additional assistance from outside the board/management or to set up a sub committee of [the] board, perhaps with the CEO. The fact that a change in board procedure has been necessary is a positive signal to [the] CEO and management that performance variance must be faced up to and addressed [by everyone, particularly the entrepreneur].
>
> (interview with VC "B", 2003)

The *consequences* of action strategies used by entrepreneurs and VCs are really a manifestation of the level of trust at any point in time. Entrepreneur and VC *reactions* (See Figure 10 – bottom row) are a response to the actions and behaviours of each other, and when assessed in terms of the properties of these *reactions* (i.e. emotion, exert control; accusation, resentment, frustration) help to indicate the level of trust in relationships. The data indicates that VCs regularly impose stricter control over their ventures during poor performance, using whatever formal mechanisms are available.

Entrepreneurs on the other hand do not have access to the same control mechanisms as VCs. As such they seem to react more emotively to firm performance and the level of trust, as reflected by the properties of accusation, resentment, frustration and emotion identified under the *entrepreneur reaction* category.

It is unsafe to assume from these results that poor venture performance is a causation of low trust. More accurately, the evidence suggests that poor performance often changes the relationship between entrepreneurs and VCs in a negative way, which commonly reduces the level of trust.

On a final note, the outcomes of the paradigm model suggest that the six properties of *entrepreneur reaction* and *VC reaction* combined can be regarded as proxies for gauging the level of trust in the relationship with their VC.

In summary, the results of this research present the following important discoveries. Firstly, entrepreneurs and VCs are generally comfortable with the formal structures imposed at the start of their ventures. The contractual and governance features of the model do not appear to have any direct relationship with assessments of trust at the start of these ventures, but may incorporate risk premiums. Entrepreneurs acknowledge their being in a weaker position of power than VCs, attributable to a belief that the one with the cash has control. The level of trust between entrepreneurs and VCs does not appear to increase dramatically throughout the term of the venture, but in the absence of major venture performance or relationship problems does gradually increase nonetheless. However, there is sufficient evidence that trust is also commonly susceptible to deterioration, especially according to VCs. Evidence of proactive relationship development strategies is absent. Expectations play an important role in determining behaviours and when venture performance tumbles relationships are easily strained and results in mostly destructive action strategies by partners. The partners' levels of pragmatism, emotion and interpersonal skill play a role in determining what remedies are used to rescue a deteriorating relationship and their degree of success.

PART IV:

4. Discussion

4.1 Introduction

The third and final objective of this thesis was to model the development of trust in venture capital financing relationships. This objective is achieved in the following manner. Firstly, further meaning in the research results is acquired by establishing a core group of findings. Next, drawing upon these findings an empirical model of the development of trust in venture capital-financing relationships is presented. Finally, a comprehensive discussion elaborates on the newly created model using the explanatory power of the trust development construct devised in Part I of this thesis.

4.2 Modelling the Development of Trust

4.2.1 The Core Findings

Returning to the results of the research, application of the paradigm model (Strauss and Corbin) 1990 revealed a number of pertinent overall findings about the relationships between entrepreneurs and VCs. Importantly, when combined with theoretical propositions the findings provide sufficient information about the relational dynamic within venture capital-financing relationships to derive a model illustrating the development of trust over the period of a venture. An important caveat of the model is that it seeks not to measure absolute levels of trust within the relationship but to illustrate critical junctures of change in the relationship expressed in terms of fluctuating levels of trust. In answer to *why* the changes in the level of trust might occur, empirical and theoretical perspectives provide comprehensive insights, as will become apparent throughout the discussion that follows.

According to the data, New Zealand venture capital relationships exhibit the following core findings:

1. Contractual aspects of the venture capital-financing model favour VCs, providing them substantial formal control. This indicates VC motivations to redress a perceived power imbalance in favour of the entrepreneur due to information asymmetries, moral hazard and perceived risk.
2. The use by VCs of contractual remedies for resolving disputes commonly has an acutely negative impact upon trust. The impact may be alleviated by VC action strategies that are perceived to be fair by the entrepreneur.
3. An abrupt reduction in the level of trust between the entrepreneur and VC following an acutely destructive incident is generally unrecoverable. Trust remains low or diminishes further following the incident.
4. Perceived poor venture performance is a common catalyst for relationship deterioration, and usually impacts negatively on trust. The impact is affected by expectations and behaviours of the parties (e.g. VC resorting to formal controls and/or entrepreneur restricting information flows to VC).
5. Interpersonal dynamics between the entrepreneur and VC throughout a venture relationship are an important predictor of trust development as are individual expectations and perceptions about the nature of the relationship and respective roles within it (e.g. partner abilities and contributions).
6. The level and growth of trust between entrepreneurs and VCs throughout their relationship is generally moderate though susceptible to dissolution. A theoretical

and empirical outcome of this observation is that not only are relationships tenuous but they also fail to optimise value creation opportunities in venture performance itself. Trust exploitation has both defensive and proactive potential with apparently only the former receiving some level of recognition within venture capital-financing relationships.

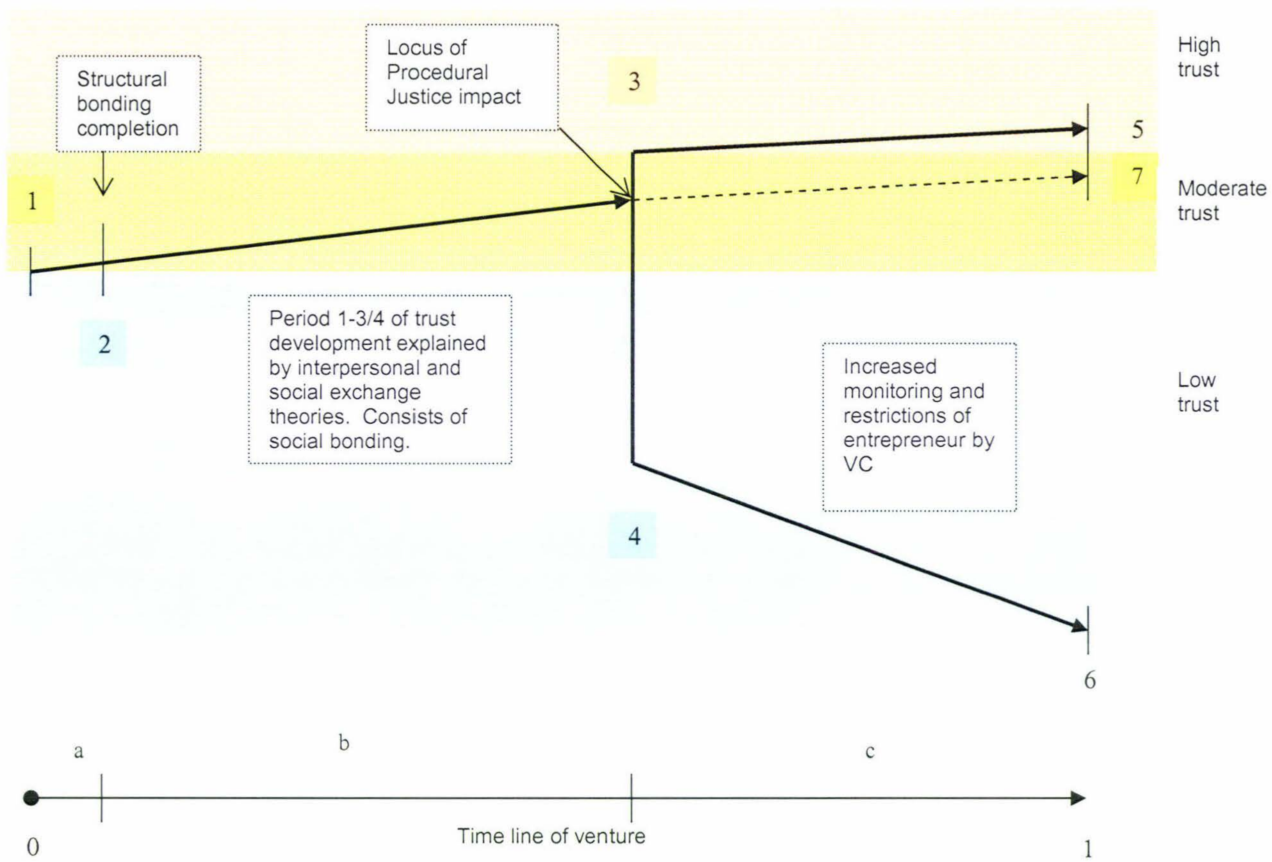
7. Entrepreneurs and VCs often bring different mindsets and traits to ventures with different response behaviours. VCs typically view entrepreneurs as lacking pragmatism and emotive in their responses to relational problems. The issue has implications for relationship development and dispute resolution because it increases the difficulty of attaining effective communication and reconciling disagreements between entrepreneurs and VCs.
8. Deliberate trust building strategies and interventions are generally not pursued by the participants, particularly in terms of the development of personal/social relationships.

The above findings were derived from the empirical results of this research and represent the most salient factors for describing and modelling the development of trust across the term of venture capital-financing relationships. The modelling process to follow incorporates germane features of the previously developed theoretical framework to indicate their explanatory power at critical junctures of change in the trust development dynamic.

4.2.2 Model of Trust Development

Figure 11

The Development of Trust within Venture Capital-financing Relationships in New Zealand



Investment phases (timeline 0 – 1)

a. Pre-investment phase; investment agreement (including contractual conditions) negotiated between VC and entrepreneur

b & c. Post-investment phases (two phases account for possible change in trust development, as indicated in model)

Table 12

Key Event Points of Relationship

Juncture Point in Model (Figure 11)	**Outcome**
1	Commencement of pre-contractual relationship
2	Financing agreement formalised; initial VC financial injection
3	Acute incident (positive) – trust level increases despite contractual remedy or threat thereof by VC; emphasis on procedural justice (associated with satisfactory investment outcome at points 5 or 7 -VC investment exit)
4	Acute incident (negative) - trust undermined/relationship deterioration due to contractual remedy by VC (e.g. withholding capital, entrepreneur replacement, board veto); expectation of association with unsatisfactory investment outcome. VC commonly exits at point 6
7	VC exit – trust maintained/stable within moderate parameters; emphasis on social exchange theory and cooperation theory (prisoner's dilemma) for explanation of progression from point 1; investment outcomes may be variable

4.3 Explanation

The initial level of trust indicated in the above model of trust development is explained by entrepreneur and VC perceptions and expectations, the latter being one of three main categories (phenomena) identified in the research results. By and large, entrepreneurs and VCs especially, believe contractual conditions between them to be fair. Importantly, little significant adjustment to these conditions appears to be made to accommodate the different needs or characteristics of different ventures. Tangibly illustrating this factor is the observation that all ventures canvassed in this study specified fixed monthly board meetings prior to any acute crisis incident. Critically, although the venture capital model initially meets the needs of entrepreneurs and VCs, it does not necessarily promote the development of the relationship that follows contractual commitment. The fact that many a relationship derails following commitment starkly contrasts the static nature of the venture capital model with the *process* of relationship development. It comes as no surprise that an acceptable contract can be established between the parties prior to a process of interaction which must endure all the strains and pressures of an operational venture. The true test of the model and abilities of the parties are revealed during the process of interaction when the risk of loss is present.

According to the research data, where changes were made to contractual conditions later in ventures, they were not necessarily associated with deterioration in relationships. Presumably, monitoring and control mechanisms, including the level and types of monitoring and frequency of board meetings do not initially affect trust and may even help to establish it, as purported by Das & Teng (1998) and Shepherd & Zacharakis (2001). This is due to pre-conceptions on the part of both entrepreneurs and VCs about what types and level of monitoring and control to expect, based upon initial business risk assessments. Additionally, entrepreneurs may exhibit a willingness to accommodate VC demands to ensure deal closure, despite dissatisfaction with various conditions of the deal. This does not necessarily influence the initial level of trust however. These aspects are negotiated between the parties at the start of venture relationships at which time neither has extensive knowledge about the other. For this reason the parties make little or no association of risk with perceived levels of trust in their venture partner, as against expected trust levels within the generic relationship based on individual experience. These expectations may be quite different between the parties. In fact, VCs report moderate to strong levels of trust at the commencement of their venture relationships. They can do so because of the venture and entrepreneur assessment period ("a" – refer Figure 11) prior to formal commencement of the venture. VCs are unlikely to commit to an investment where a required threshold of trust in the entrepreneur is not reached, or a good *fit* (Shepherd & Zacharakis, 2001) is not achieved.

Institution-based trust (Rousseau, 1998) assessments are most valuable at this point (i.e. formal qualifications, professional body registrations, peer references, etc) to compensate for information deficiencies between the parties. To note however is that initial trust assessments typically make allowance for the presumption that "everybody is on their best behaviour"[11]. Hence the accuracy of trust-based assessments is inherently subject to distortion at the start of venture relationships.

Continued analysis of initial trust levels reveals VCs establish a set of rules, in terms of contractual conditions, monitoring and control mechanisms and governance arrangements, to compensate for being in a weaker initial power position compared with the entrepreneur (Mayer et al., 1995). Evidence of the initial power differential can be found in the present research data (see survey results, section J, Appendices I & J) concerning prevalence of contractual terms. The imposition of contractual covenants is in part intended to redress power imbalance detrimental to the VC. The most oft cited terms in venture contracts relate to restraint of trade, VC approval of key decisions and limitations on entrepreneur activity. Closely following these terms in order of priority are entrepreneur employment contract and milestone requirements. The priority and prevalence of these terms exceeds those relating to financial aspects and is a convincing expression of power relations at the commencement of ventures between entrepreneurs and VCs. These rules are not designed to specifically compensate for a lack of actual trust but to counterbalance this power differential to re-distribute perceived investment risk. This is an important distinction. Therefore, contractual manifestations of power-building by VCs may not be a power-grabbing exercise, so much as

[11] Personal quote from interview (Nov. 2003)

a power re-balancing effort in light of inherent information asymmetries and control discrepancies between the entrepreneur and VC at the commencement of ventures.

The research results indicate that VCs' generally perceive monitoring and control mechanisms available to them in their ventures as effective. Regardless, they expressed less certainty concerning equality of power and loss of control. In explanation for these observations, VCs may lack awareness of governance strategies available to correct their perceived control and power inequities. VCs appear inclined to enter relationships with extensive contractual agreements designed to cover all such monitoring and control contingencies, but then only call upon such necessary governance mechanisms for punitive recourse. A possibility exists that VCs lack the necessary skills at board level to implement alternative governance remedies which do not carry inherently destructive tendencies. Further, given control and power equality are both perceptual and real, it is possible that such remedies are perceived as unsuitable for anything beyond tangible problems rather than creating value within relationships. Simply, governance mechanisms are restricted to a narrow field of applications consisting of monitoring and control, while excluding alternative value-creating applications for relationship development such as independent mediation, relationship building initiatives and evaluation and performance improvement strategies. This would help to explain the lack of trust creation in ventures examined in this project. Moreover, where a dearth of trust prevails, entrepreneurs, according to prisoners' dilemma theory, are less inclined to relinquish their main source of control – tacit knowledge. Pfeffer (1985) asserts that knowledge, especially from the entrepreneur's perspective, is the predominant mechanism for control and therefore relational power.

Typically, once an entrepreneur has approached a VC for funding and satisfied preliminary criteria, a significant period is spent by the VC researching the proposed venture prior to their final investment decision and committal at point 2 in the trust development model. A great deal of emphasis is placed upon making the *right* investment from the start. This is achieved in the deal structuring and post-investment activity (Sweeting & Wong, 1997). This period is apparently used by VCs in particular, to assess the relational compatibility of the entrepreneur. The assessment process in New Zealand is generally informal and described in terms of being able to *get along with the entrepreneur over a beer*. In light of research results, this assessment process may be a rather poor predictor of future relational harmony. In light of character judgements by VCs based mostly on instinct, an imperative exists for proactive relationship development both before and following deal signing to counter this imprecise and dubious assessment methodology. Importantly, this unstructured relationship assessment process is a component of the venture capital model which subjects both entrepreneur and VC to risk. Entrepreneurs and VCs, as indicated in the above model, indicate moderate to high initial trust levels based upon generic and instinctive assumptions as explained. Such perceived levels of trust may in fact be very misleading in terms of predicting relationship outcomes.

Traditionally, agency theory has been used to describe behaviour-based contracts, where the actions of the agent were sought to be controlled by the principal, to meet the latter's own objectives. However, the venture capital model used in New Zealand, as elsewhere, actually manifests as a combined behaviour and outcome-based contract. This occurs because the business objectives of both entrepreneur and VC are aligned via equity sharing arrangements. This explains the need for a multi-theoretical approach, as applied in this research, to explaining trust development in these relationships. The outcome-based component of the model implies a cooperative paradigm of interaction, *in addition* to typical mechanisms of monitoring and control prescribed by agency theory.

However, contrary to the views of Cable and Shane (1997) the entrepreneur/VC relationship, despite having characteristics inherent to a paradigm of cooperation is ultimately one of agent and principal – as evidenced by the contractual nature of the relationship and formal control available to the VC, regardless of it's application. Agency based analysis was included in this research on the grounds that venture capital-financed ventures *do* use agency-based mechanisms for control and monitoring purposes. What is apparent, as captured by the venture capital model, is that agency theory control mechanisms are available for exploitation by the VC in the event of crisis. This effectively affords the VC a dominant position over the entrepreneur. At crises points 3 and 4 in the model of trust development (Figure 11), the shape of trust to follow is reliant upon the method of crisis management by the VC, with particular influence by procedural justice concepts. This means that the manner in which disputes are resolved and perceptions of *fairness* are crucial in shaping outcomes. The research results indicate that constructive and trust-reinforcing action strategies by both entrepreneurs and VCs are infrequent. Many factors appear to contribute to this problem, as apparent in the results and previous theoretical discussion.

In the absence of a relationship breakdown it appears that formal controls contracted between the parties at the commencement of ventures are relatively benign. However, the dormancy of such control belies the risks they pose to the outcome of the relationship and possibly overall venture success. Indicated in the results of this research is that poor venture performance is a catalyst for relationship deterioration, impacting the development of trust. Where conflict arises in such situations the application of either informal defection behaviours by entrepreneurs or formal structural remedy by VCs depends on the action strategies they pursue, as guided by the previous nature of the relationship. Hence the benevolence of these strategies and their impact upon trust is effectively explained by the concepts of social exchange theory and procedural justice theory. Recall that social exchange theory posits a relationship of interdependence and relationship development through frequent interaction, while procedural justice theory states that fair and consultative decision-making stimulates trust. If the imposition of formal controls is potentially one of the more destructive outcomes on venture capital relationships, as indicated by the research results, then the role of these two theories is particularly important in their explanatory power and incorporation in the model derived for this research. This is because firstly, the use of unfairly punitive actions by VCs may be negated by the creation of deeper relational bonds, mutual understanding and trust, as suggested by social exchange theory. Secondly, in the event that punitive action is taken by VCs in particular, the implementation process is critical to determining the entrepreneur response. Trust may very quickly be undermined.

Although agency theory underpins the entrepreneur/VC relationship, it does not necessarily account for the way the parties interact until the point of relationship breakdown and failure. Sweeting & Wong (1997, p.134) suggest that "beyond a certain point" VC/entrepreneur relationships convert into a principal-agent paradigm, often the result of a relationship breakdown or poor venture performance where greater VC monitoring and control is demanded as already noted at point 4 in the model. They further make the point that reversal of such a change is "very difficult, if not impossible, particularly if existing personalities continue to be involved" (1997, p.134), again supported by the evidence in this thesis. These observations have implications for the trust development construct applied to analysing entrepreneur/VC relationships. The explanatory power of each theory comprising the construct appears to shift over the course of ventures, depending on changes in the relationship. This implies that the relationship does not follow a linear path, further reinforcing the need for a multi-theoretical approach to understanding the trust development dynamic, as applied to this research.

A complicating factor in understanding venture capital relationships, as explored in the earlier literature review, is that any given level of monitoring can not automatically be assumed to be inversely related to trust. Further, entrepreneurs are apparently capable themselves of perceiving a mutual benefit in maintaining trust via application of certain levels of monitoring by the VC. Such an attitude is expected to remain as long as trust prevails. Where a breakdown in the relationship does occur, and trust is breached, it seems that defection behaviours by entrepreneurs are common, as implied by prisoner's dilemma thinking. Interestingly, entrepreneur defection commonly appears to manifest in surreptitious behaviours, to avoid increases in VC monitoring and control. This may be related to their supposedly emotive dispositions, as expressed by VCs in the research results. In such instances significant damage to the venture in terms of success prospects can occur because of entrepreneur sabotage.

Prisoner's dilemma theory draws a link between cooperation and trust. However, causation is uncertain, in as much as it can be argued that trust encourages cooperation (Williams, 2001; Mayer et al., 1995) and vice versa. In the context of this study, without previous engagement between the entrepreneur and VC, cooperation must be present for trust to develop. A parallel can be drawn here with social exchange theory. Only once a period of interaction is complete can each party develop an understanding of the other's behaviours and attitudes under various circumstances. This in turn allows each party to determine how much they will trust the other. Cooperative behaviours encourage trust-building, hence the gradual increase in the level of trust between points 2 and 7 in the venture capital model. In the absence of any acutely destructive incidents, trust can be assumed to increase as a matter of course via constantly repeated positive interactions.

The process of interaction between the entrepreneur and VC is fundamental to venture outcomes. The relationship, given the contemporary operating model, is inherently predicated upon cooperation. The parties are free to interact, and cooperate, as they choose, but face constraints in terms of limitations imposed by the behaviours of the venture partner. Therefore, the nature of cooperation can be expected to vary, but ultimate control of the venture rests with the VC as explained.

All venture capital relationships have the *potential* to maximise cooperation and mutual benefit during the relationship process. Cooperation which fulfils the objectives of both the entrepreneur and VC can be expected to diminish the relevance of destructive agent/principal control devices such as increased monitoring and reporting requirements, share dilution and withheld tranches of capital.

Affective-based trust development is limited to contexts of frequent interaction and consists of emotional bonds between individuals (McAllister, 1995). Affective-based trust appears largely absent in venture capital relationships, indicating a lack of deeper, personalised affiliation between entrepreneurs and VCs generally. Results from this study indicate a lack of interest and therefore willingness on the part of VCs in particular, to engage on a more emotive level with entrepreneurs, effectively truncating trust development. One VC stated that "this is just the way such venture capital relationships operate", implying a different paradigm was beyond their control. In fairness however, the same individual indicated it was not the role of the VC to deeply embed themselves in the operational management of their ventures. If necessary, the founding chief executive is simply replaced, yet again revealing preferential recourse to punitive remedy rather than relationship recovery. These observations have distinct ramifications, most starkly observed in the lack of trust development and often trust deterioration among the sample group. The force analysis diagram below (Figure 12, p.133) expresses these relational factors which manifest levels of trust.

Where affective-based trust is not developed, breaches of trust more readily result in actions of defection which occur at point 4 in the trust development model above. Basically, where trust is superficial, rooted in contractual agreement, and emphasises monitoring and control of actions, a weaker sense of emotive commitment to the relationship generally prevails. Accordingly, such relationships are less forgiving of untrustworthy and recalcitrant behaviours, often antecedents to relationship breakdowns. One entrepreneur revealed through discussions how tenuous trust in relationships can be where only cognitive-based trust is established and self-interested behaviour prevails. In this instance a good working relationship between the entrepreneur and VC was compromised by a breach of faith and trust due to the VC pursuing a financial arrangement promising significant financial self-reward, with complete disregard for detrimental impacts upon the entrepreneur. "It was in the contract, so they tried it on."[12]

It stands to reason that where a relationship, any relationship, deteriorates, trust between the concerned parties diminishes. The evidence from this study supports this intuitive proposition. Looking to the venture capital-financing model to explain either support for, or restrictions upon trust development, is the underlying purpose of this project. The venture capital-financing model could be expected to impact the behaviours of the participants with either positive or negative outcomes, for this is the manifestation of trust. A glaring revelation in the research results is that the existing model has no proactive trust-development component. If the structure of the model, in terms of the contractual agreement, board composition and process, and monitoring and control mechanisms are relatively fixed in any event, then the development of trust is reliant upon the agendas, traits and abilities and action strategies of the entrepreneur and VC. Apart from the behavioural interactions of entrepreneurs and VCs that comprise the non-structural aspect of the venture capital model, it is inherently unresponsive to the destructive dispositions of the participants. Theoretical assumptions aside, if the behavioural manifestations of the participants are predisposed toward low trust and destructive behaviours, the model has no means to respond except in a punitive and usually destructive way. The model exploits various control remedies (agency theory) in such instances. If in fact the assumptions of cooperation theory, explained by social exchange theory and the prisoner's dilemma do not implicitly create equilibrium and contribute toward combined participant outcome maximisation then destructive outcomes could be anticipated because the existing model cannot adjust constructively.

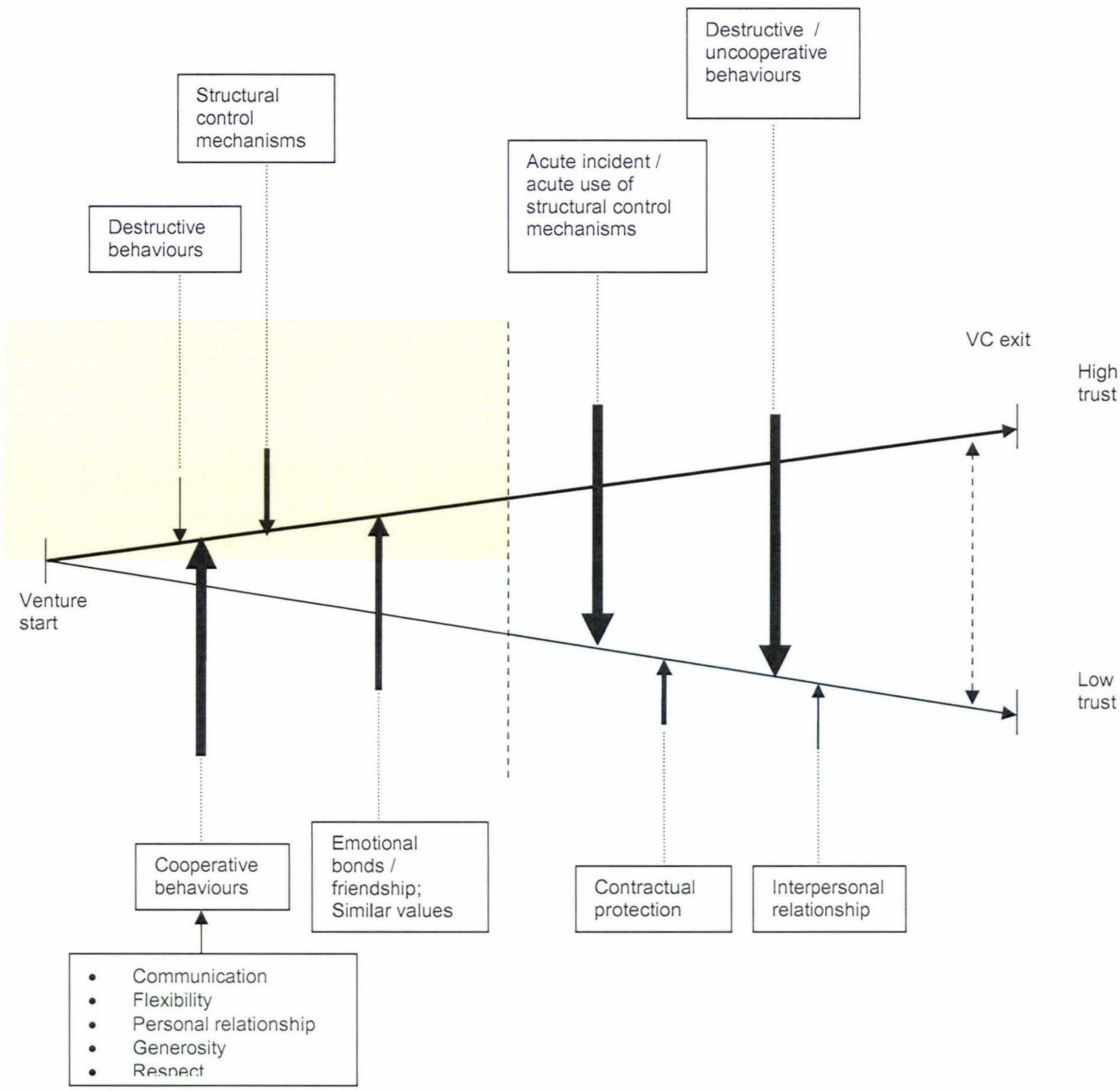
The model assumes that goal congruence between the entrepreneur and VC compels the parties toward cooperation. This outcome-based contractual view of the relationship is

[12] Interview with entrepreneur

anticipated to have a self-stabilising impact. But pragmatism cannot be assumed to be congruent with trust. In fact the motivating influence of goal symmetry may not be sufficient for cooperative behaviours to occur, as exhibited in the results of this research. Trust has a powerful emotive aspect which intuitively challenges the logic that pragmatic *cooperative* decision-making is a constant. The results of this research seem to corroborate this logic in terms of the frequency with which relationships deteriorate and trust diminishes. Just as agency based mechanisms of control act as a proxy for trust, as previously explained, they do not guarantee cooperation, as does neither goal congruence posited by cooperation theory. This apparent uncertainty about which theoretical approach dominates the relationship in venture capital financing was explained previously. The relationship is dynamic throughout the term of the venture and can only be explained at different points of relational interaction by the applicable theories of the trust development construct.

The issue of pragmatism is particularly apparent in the results. Entrepreneurs were oft cited by VCs to lack pragmatism and react to problems in an emotive manner, reducing the prospects of establishing pragmatic solutions. Many of these VC-observed behaviours approximate the theorised propositions of the prisoner's dilemma whereby rather than resolving issues, the parties tend toward defection from the relationship. The proposed equilibrium inherent to existing cooperation theory relating to the entrepreneur/VC relationship is vague on the role and impact of trust. More importantly, if cooperation was self-regulating over the relationship, why do relationships fail, as evidenced in this research. The venture capital-financing model, as already stated, is inadequate because it does not seek to address interpersonal development, of which trust is an element. It comprises both punitive recourse for undesirable behaviours and implied cooperation explained by prisoners' dilemma theory but does not promote trust development. The following force analysis diagram explains the interaction of both implicit and explicit factors impacting upon the venture capital relationship.

Figure 12



Various trust equilibriums can be achieved within a venture capital relationship, as determined by the mix of forces and their relative strengths. The boldness and direction of the arrows in Figure 12 represent the impact of different forces upon the development of trust under two conditions of high and low trust. An assumption of existing cooperation theory is that where cooperative equilibrium prevails the greater the likelihood of a successful relationship. Cooperation theory assumes pragmatic decision-making by the participants that produce favourable outcomes. Disruptive behaviours due to interpersonal acrimony or self-serving agendas, however, may prevent equilibrium despite pragmatic behavioural assumptions of the existing venture capital model, thereby jeopardising favourable outcomes.

4.4 Summary

This discussion firstly derived eight core findings from the empirical results of this research as follows:

1. Contractual aspects of the venture capital-financing model favour VCs.
2. The use by VCs of contractual remedies for resolving disputes commonly has an acutely negative impact upon trust.
3. An abrupt reduction in the level of trust between the entrepreneur and VC following an acutely destructive incident is generally unrecoverable.
4. Perceived poor venture performance is a common catalyst for relationship deterioration, and usually impacts negatively on trust.
5. Interpersonal dynamics between the entrepreneur and VC throughout a venture relationship are an important predictor of trust development as are individual expectations and perceptions about the nature of the relationship and respective roles within it (e.g. partner abilities and contributions).
6. The level and growth of trust between entrepreneurs and VCs throughout their relationship is generally moderate though susceptible to dissolution.
7. Entrepreneurs and VCs often bring different mindsets and traits to ventures with different response behaviours.
8. Deliberate trust building strategies and interventions are generally not pursued by the participants, particularly in terms of the development of personal/social relationships.

These findings were then used to create a model of the development of trust within venture capital-financed relationships. An extensive analysis of the research findings and the model followed (Figure 11, p.121), incorporating and developing further the explanatory power of the theoretical trust development construct. The construct consisted of five theoretical propositions, including agency theory, prisoners' dilemma theory, procedural justice theory, social exchange theory and interpersonal trust theory.

The model indicates that generally entrepreneurs and VCs commence their relationships with a moderate level of trust, intuitively based upon expectations rather than experience of interaction. Barring any acute destructive incident within the relationship, often caused by poor venture performance, the level of trust tends to increase marginally throughout the term of the venture, apparently due to a lack of proactive relationship development initiatives. Ultimately the relationship represents a principal - agent paradigm where the VC has control over outcomes due to contractual dominance. Although, agency mechanisms may be redundant or remain dormant in instances where the partners can engage cooperatively. There are no indicators from the research that the actors perceive trust development itself as a means to stabilise the relationship nor to increase the prospective value of the venture. In fact, more commonly rather than proactive value creation, the venture capital model in its current form encourages punitive exertion of VC control in a purely reactive capacity.

The dynamic of trust development appears to fluctuate across the term of ventures as the actors are influenced by their evolving relationship. Accordingly, the explanatory power of the theoretical trust development construct is non-linear throughout the venture. This justifies the multi-theoretical approach to explaining trust within these relationships as the different theories comprising the construct are necessary to explain the dynamic at different times depending on the mix of relational variables.

5. Conclusion

5.1 Summary of Thesis

The introduction to this thesis identified venture capital as an important requisite for growth in any modern economy, including that in New Zealand. Also illustrated was growing recognition in the literature of the role of interpersonal relationships and their contribution to determining success in business generally. More specifically, issues of trust in business relationships have become increasingly topical for increasing business performance. The literature asserts that relationships with high levels of trust function at a higher level of performance than those lacking trust. This being so, the product of higher performing relationships appears to be higher performing ventures. The results of this research support this proposition, though in the inverse, revealing an association between poor venture performance and low levels of trust caused by deterioration in entrepreneur/VC relationships.

The venture capital model, despite celebrating the merits of goal and incentive alignment, represents a principle – agent paradigm. The evidence here indicates clearly that where the control mechanisms associated with this paradigm are implemented, relationship deterioration follows. Alternatively, relationships based on higher levels of trust, negating strict formal control may improve venture performance. Despite such prospects, the value of proactively building trust does not appear to be recognised by those engaged in venture capital-financing relationships. This suggests that the model in its current form does not exploit the potential of cooperative relationships, this being largely due to its lack of responsiveness to the interpersonal dynamic between entrepreneurs and VCs generally. The product of the static model, based on the literature and evidence of this research, is presumably sub-optimal venture performance.

The research problem in this thesis was a dearth of focus in the literature on the role of trust in relationships between entrepreneurs and VCs. More specifically, little emphasis has been given previously to exploring how specific features of the venture capital-financing model constrain or liberate the development of trust within these relationships. As a consequence, the application of existing theory to explain the interpersonal dynamics within these business relationships has been inconclusive. In answer to the research problem, three objectives were determined. These are expanded on below.

Part I of this thesis provided a theoretical framework and definitions of the various key components of the research. Commencing this section were explanations of venture capital and the financing model prevailing in New Zealand. Following an extensive review of the literature five relevant theories were described as important for analysing venture capital-financing relationships and a trust development construct was presented (Figure 2. p,65).

Part II outlined the project's methodology. This consisted of a mixed-method, qualitative approach using an adaptation of the grounded theory research method. This method was appropriate for inductively illustrating the development of trust in entrepreneur/VC relationships. A mail survey and semi-structured interviews were used for data collection, while Section 2.5 outlined the data analysis process. Semi-structured interviews in particular suited the methodological approach in this thesis, where salient features of entrepreneur/VC relationships emerged by iteratively making comparisons and asking questions of the accumulating data.

The research results were presented in Part III, using the grounded theory method. Twelve categories were revealed during the coding process, comprising three phenomena categories titled *expectations, relationship and trust development.* Application of the paradigm model was further illustrated to reveal inter-categorical relationships.

Finally, Part IV fulfilled the third objective of the thesis in which a model of the development of trust in venture capital-financing relationships was presented. Assisting derivation of the model was the extraction of eight core findings from the research results, drawing explanatory support from the theoretical trust development construct presented in Part I of the thesis.

5.2 Conclusions

This thesis consisted of three primary research objectives. This section reviews each objective and assesses whether or not they were achieved in light of research outcomes.

Objective One: To describe the model of venture capital financing commonly observed in New Zealand. This objective was fulfilled in Part I of the project where the New Zealand venture capital industry was described in detail and features of the venture capital-financing model were defined. The local industry differs to some extent from that found in other countries in terms of the preferred investment vehicle, industry segmentation and maturity and the sources of funding. The financing model itself differs little to that in other countries although a contentious issue generally is the level of both investor and entrepreneur expertise. The evidence, however, is largely anecdotal.

Objective Two: To establish an appropriate theoretical framework (construct of trust) to use as a tool for the assessment of trust development in venture capital relationships. This second objective was successfully achieved in that a trust development construct was derived from the literature. A holistic theoretical assessment tool such as the construct developed for this project had not previously been conceptualised. The literature is quite fragmented in terms of applying different theoretical perspectives to cooperative relationships, with trust generally discussed in the context of a by-product of such relationships. Moreover, such a comprehensive linkage between theoretical propositions and venture capital relationships has not previously been undertaken.

Objective Three: To construct a model that charts the development of trust in venture capital relationship. Again this objective was successfully achieved. The results of this research produced evidence of critical junctures in the development of trust between entrepreneurs and VCs. Although the graphical display of the model proved reasonably simplistic, the theoretical explanations supporting its design are complex. This was largely due to the intertwining of different components of different theories from the trust development construct. The non-linear path of entrepreneur/VC relationships throughout the course of their ventures adds additional complexity to understanding the development of trust. Each theory comprising the construct has unique explanatory power for different phases and aspects of these relationships arising from this non-linearity.

5.3 Limitations

The most conspicuous limitation to this research is the empirical data. Typically, with a sample size as small as that pertaining to this study, the reliability of the results must be taken with a degree of caution. As already indicated, the venture capital industry has a reputation for posing significant barriers to research, as recognised by scholars and researchers in the field. This may be a consequence of an industry ethos of privacy and importance of reputation. However, having adopted an exploratory approach to this area of research, the results and conclusions presented help to reveal some new insight about the role of trust in venture capital relationships. A more holistic and comprehensive understanding of the development of trust has been revealed in this project.

In particular, the survey component of the research had greater potential than was realised. A secondary objective of the research methodology was to test the trust development construct as an assessment tool. The survey component of the methodology was hoped to fulfil this ambition and hence add a further degree of utility to the construct. This objective was unable to be realised, however, without a more substantial empirical response. Ultimately the residual value of the survey data was to guide and support the direction of later interviews, as intended, though without affirming the efficacy of the trust development construct as a tool itself.

Another limitation, touched on previously, concerns individual traits and behaviours which may lie entirely outside the venture capital model developed here. Staw (1991) refers to the "psychology of demographic variables" to explain the problem of interpersonal relations. The propensity of individuals to display behaviours based on specific psychological profiles seems an appropriate consideration with respect to entrepreneurs and VCs in terms of the impact upon trust outcomes. "It remains worthwhile to carefully study the role of the individual, including his or her psychological profile" (Johnson, 1990, p.48). This field of research is beyond the scope of the current study, but would add a further degree of complexity and sophistication to the modelling process. It is noteworthy that the literature relating to the study of entrepreneurs has not pursued these areas of inquiry, despite some authors arguing the uniqueness of such individuals. For example, Armstrong & Priola (2001) refer to the intuitive cognitive style of entrepreneurs. The preoccupation in the literature to-date has been in attempting to understand the personalities or characteristics and behaviours of entrepreneurs that result in entrepreneurial actions.

Two final limitations concern representativeness of the research populations. Organisational VCs and private equity investors were bundled into a single VC population for this thesis. Some aspects differentiating the two types of investor lend themselves to treating the groups differently, despite engaging in similarly collaborative ventures with entrepreneurs. For instance, private equity investors appear more likely to have previous experience running their own businesses and are typically more "hands-on" in the way they interact with their investments than VC organisations. Separating the groups may reveal additional characteristic nuances in their venture engagements. Also, in terms of representativeness, the response rates for entrepreneurs and VCs should be similar for balance in the findings.

5.4 Future Research

Several initiatives flowing from this project that require further examination are identified here. Firstly, validation of the trust development construct as a tool for assessing the level of trust in venture capital-financing relationships would make a significant contribution to this research field. A serious obstruction to such an initiative is the small size of the venture capital industry in New Zealand and the need to overcome inadequate sample sizes. However, it is feasible that the construct, with minor adaptation, may be applicable to other institutional settings, permitting its standalone validation. Alternatively, its application to venture capital industries in other countries would likely also provide desirable qualification.

A second valuable initiative would involve empirical qualification of the relationship between venture performance and trust, possibly using the trust development construct derived in this project. This linkage would prove invaluable in terms of expressing the value of inculcating trust into business relationships. For until a bottom line indicator of the value of trust is proven and recognised, the true value of pursuing trust in business relationships will continue to be under-represented in management philosophy and practice, as is currently the case.

Also, further research into the field of trust development in venture capital relationships should produce recommendations for improving the venture capital model used in New

Zealand. Additional or more effective means of increasing trust within the current model may be sought. This may include suggestions for specific interaction between entrepreneurs and VCs which increase trust between them. Using the theoretical basis developed in this study, a phase of creative exploration could be pursued in terms of intervention strategies and trust development tactics. This in effect, would contribute to organisational development theory and practice.

APPENDICES

APPENDIX A

Dear [Respondent],

I kindly request your participation in this study exploring venture capital/private equity financing in New Zealand.

This study comprises the thesis research component toward my Master of Business Studies Degree at Massey University.

Venture capital/private equity is now seen as a vital component of New Zealand's quest for economic progress. This unique research is timely in its contribution to better understanding the role of venture capital/private equity in New Zealand and the way Entrepreneurs and Investors interact. Specifically, this research seeks to examine the issue of trust in venture capital-financed business relationships in New Zealand.

It is hoped that, with your support, this research will provide valuable information, and act as a useful tool for investors and Entrepreneurs alike.

Action Required

Action step ONE

Select up to 3 Venture companies (Current or Historic) to <u>SEND</u> questionnaires to.

This research seeks information from both you, as the Venture Capitalist/Private equity provider, and the Entrepreneurs from the firms you or your company financed.

As you might imagine, my ability to identify and contact actual private ventures in receipt of venture capital finance, as an outsider, is difficult. I must therefore rely upon your assistance in this respect.

Included with this pack are three envelopes, each generically entitled Entrepreneur questionnaire.

Your assistance is requested to **forward on** these envelopes, containing questionnaires, to Entrepreneurs from each of three of your **Venture Companies**. These companies can be ventures either current or historic (See "Eligibility" Section below for explanation of these terms).

I ask that you address each of the 3 envelopes and freepost them to their respective recipients.

Please keep a personal note of which firms you send question the questionnaires to.

Action Step TWO

Select <u>up to</u> 2 ventures <u>YOU</u> wish to complete questionnaires for

Venture eligibility

Please select at least one venture, preferably two, from your current and/or previous investment portfolio which meet either of the following criteria

.

1) **CURRENT Ventures** – Includes only ventures in which you have been involved for at least **6 months since first round financing.**

OR

2) **HISTORIC Ventures** – Includes only ventures which ended **not more** than approximately two years prior to the current time.

If you can identify venture/s satisfying the above criteria, please continue on to the instructions page of the questionnaire.

Please complete and return questionnaires in the **pre-paid envelope supplied**.

Any inquiries in relation to this research can be directed to me personally, or my University Supervisor at the following contact points:

Anthony Gibbons (Researcher)
[redacted]: gibmons[redacted]actrix.co.nz
[redacted]

Ms Coral Ingley (Supervisor)
Massey University (Albany Campus)
Email: C.B.Ingley@massey.ac.nz
Ph: 09 443 9700 ext. 9572

Please return your completed questionnaire/s by no later than **15 September 2003**.

Naturally your full privacy and confidentiality in this project is assured and you are under no obligation to participate.

I thank you for your interest and support in this research.

Yours sincerely,

Anthony Gibbons

APPENDIX B

INVESTOR QUESTIONNAIRE

Please read the following instructions **BEFORE** answering the questionnaire

Venture Selection

You have been supplied with two identical questionnaires. I encourage you to select two separate ventures from your investment portfolio to consider in this survey.

If you do choose two ventures, you must complete **one questionnaire for each venture**.

Note that for the purpose of this research, the terms *venture capital* and *private equity* **refer to the same type of financing arrangement**. However, "venture capital" will be the term used on every occasion to follow.

To qualify as **"venture capital"** ventures, the following criteria MUST apply:

1. The investment is of a limited tenure, with an intended future exit point
2. You, as the investor, have taken an equity stake in the investment
3. The investment goal is accelerated venture growth, as distinct from seed funding. This may include both start-up and latter phase ventures.
4. At least one Director on the venture company Board represents the VC

Please Note:
Though you are requested to forward questionnaires to several of the venture companies your company financed, it is not absolutely necessary for the questionnaires *you* complete to relate to these firms. These firms will return the questionnaires to the researcher directly.

Where you decide to complete both questionnaires for two separate ventures, I further encourage you, if possible, to select what you believe to be one successful venture and one under-performing venture. This will help to enrich the data collated.

The Questionnaire

Relevant Time Period to Consider

When answering the questionnaire:

1) If referring to a **current venture** - Consider the relationship with the venture company **ONLY AROUND THE PRESENT TIME.**

2) If referring to an **historic venture** – Consider your formal relationship with the venture company in its **FINAL YEAR OF EXISTENCE.**

Note: Your responses to the questionnaire require you to consider your relationship with the venture company. For the purpose of this research, in many instances this requires you to **think of the original entrepreneur/s** from the venture company.

This will be the individual in the role of **executive director** at the time the formal relationship between you and the venture company commenced. Furthermore, this individual must have held an equity stake in the firm at this time of **not less than 15 percent.** Essentially, this person is the owner/entrepreneur of the firm who had / has a role in managing the business and who sat / sits on the Board of Directors.

Should more than one individual from the ventures you use fulfil these criteria (e.g. co-owners of a firm), combine them together into a single identity. So when answering the questions think of co-owners as a single voice. This is necessary to put your thoughts into a personal context.

In circumstances where the original entrepreneur has resigned or been replaced, your questionnaire responses must **relate only to the original Entrepreneur.**

Who should complete the questionnaire/s?

This questionnaire is designed to be used by BOTH individuals AND companies, acting as venture capital investors.

Questionnaires for each chosen venture must be completed by the person who...

1) **Holds/held a board position** in the venture company being financed

Or

Where no board position is/was held, then the person from your firm who acted as the **main liaison** between your firm and the venture company for the duration of the relationship.

Question Formats

Where a statement is made, you are required to indicate how much you either agree or disagree with the statement using a **1 to 5 numbered scale.** Please circle the number that best approximates your opinion.

Example **(1)**

1	2	3	4	5
strongly disagree	disagree	neither agree nor disagree	agree	strongly agree

In a similar fashion, other statements use a self-explanatory numbered scale to measure your opinion.
Example **(2)**

I feel the overall level of monitoring (both informal and formal) of my actions and activities by the entrepreneur is.

1	**2**	**3**	**4**	**5**
Very low	low	fair & reasonable	high	excessive

Things to know

1) The questionnaire is worded in every instance as though referring to the present time. If you are referring to an **historic venture** in your responses please place the questions in the context of the last year of your venture's relationship with the Entrepreneur. (see example **(3)**).

Example **(3)**

I *felt* the overall level of monitoring (both informal and formal) of my actions and activities by the Entrepreneur *were*.

1	**2**	**3**	**4**	**5**
Very low	low	fair & reasonable	high	excessive

2) **Venture Capitalist** in the questionnaire is abbreviated to **VC**

3) **Venture Company** in the questionnaire refers to the firm being financed by you or your firm

Confidentiality

Remember that your responses in this study are **strictly confidential** and that results will be aggregated with other questionnaires.

The results of this research are intended to better understand the venture capital industry, not single out individual business ventures for scrutiny. Therefore, there is no risk of your questionnaire responses being individually identifiable. All completed questionnaires will be destroyed upon collation of their data.

Now please proceed to the start of the questionnaire.

Venture Capital Relationships– WHERE'S THE TRUST?
Investor/VC Questionnaire

Section A

Q1. The venture you'll be referring to in this questionnaire is
(answer with a "√" tick)

O	O
Historic	Current
Go to Section B	**Go to Section C**

Section B

Historic Ventures Only

Q1. In what year did the formal business partnership between you or your VC firm and the venture company end? (Circle appropriate number above the answer)

1	2	3
2001	2002	2003

Q2. How many years did your you or your firm have a formal relationship with the venture company? (circle the appropriate number) (round your response up or down to nearest number of years)

1	2	3	4	5
Less than 2 yrs	2-3 yrs	4-5 yrs	6-7 yrs	8 yrs +

Q3. In your opinion, the overall performance of the venture company at the completion of the business relationship was

1	2	3	4	5
very poor	poor	satisfactory	good	excellent

Q4. How much responsibility do you assign the Entrepreneur for your answer in Q3?

1	2	3	4	5
no responsibility	very little	moderate	most	full responsibility

Q5. Is the venture company still operating as a going concern?

1	2	3
Yes	No	Don't know

Proceed to Section D

Section C

Current Ventures Only

Q1. How many years have you or your VC firm been in a formal business relationship with the venture company? (choose an answer nearest to the number of years)

1	2	3	4	5
Less than 2 yrs	2-3 yrs	4-5 yrs	6-7 yrs	8 yrs +

Q2. In your opinion, the overall performance of the venture company at the current time is

1	2	3	4	5	6
very poor	poor	moderate	good	excellent	Uncertain Go to Section D

Q3. How much responsibility do you assign the Entrepreneur for your answer in Q2?

1	2	3	4	5
no responsibility	very little	moderate	most	full responsibility

---

Section D

VC Profile

Q1. Please indicate the number of years you personally have been involved in venture capital financing

1	2	3
less than 3 years	3 – 5 yrs	more than 5 yrs

Q2. Have you had personal experience of owning and managing a business?

1	2
Yes	No

Q3. How many venture capital investments would you typically run simultaneously in your investment portfolio?

1	2	3
1 only	2 – 5	more than 5

Q4. In which of the following industry categories do you personally have prior working experience, either as a VC or in another business context?
(circle as many of the category letters (A – R) as required)

A Agriculture, Forestry and Fishing
B Mining
C Manufacturing
D Electricity, Gas and Water Supply
E Construction
F Wholesale Trade
G Retail Trade
H Accommodation, Cafes and Restaurants
I Transport and Storage
J Communication Services
K Finance and Insurance
L Property and Business Services
M Government Administration and Defence
N Education
O Health and Community Services
P Cultural and Recreational Services
Q Personal and Other Services
R Other

Source: NZ Stat's (ANZSIC96)

Section E

Q1. With respect to the current venture company, please indicate how actively you participate in the operational affairs of the firm.

1	2	3	4	5
no participation at all	very inactive	inactive	moderately active	very active

Q2. Do you hold a position on the Board of Directors of your venture company?

1	2
Yes	No Go to Q4

Q3. With respect to the current venture company, please indicate how actively you contribute to the strategic direction and decision making of the firm at Board level.

1	2	3	4	5
no contribution	little contribution	moderate contribution	heavy contribution	full strategic decision-making control

Q4. Generally speaking, how do you perceive the managerial competence of the Entrepreneur?

1	2	3	4	5
very poor	poor	moderate	good	excellent

Q5. Taking into account your entire non-financial contribution to the venture company, (includes managerial skills, marketing and business contacts, networks, access to other financiers, etc) how reliant do you perceive the Entrepreneur upon you for potential success in the current venture?

1	2	3	4	5
completely reliant	mostly reliant	somewhat reliant	not reliant	too difficult to determine

Section F

Q1. The personal communication between me and the Entrepreneur is open and honest.

1	2	3	4	5
Strongly Disagree	disagree	neither agree nor disagree	agree	strongly agree

Q2. The frequency of personal communication between the Entrepreneur and me outside of board meetings is

1	2	3	4	5
never	infrequent	occasional	frequent	routine

Q3. How free do you feel to discuss with the Entrepreneur problems and difficulties you are experiencing with the firm without jeopardizing your relationship or having it "held against" you later?

1	2	3	4	5
No freedom	mostly lacking freedom	neither free nor lacking freedom	somewhat free	completely free

Section G

Q1. To what extent are you satisfied with the way the Entrepreneur makes general decisions concerning the venture company? (e.g. unfair and ill-considered - fair & reasoned)

1	2	3	4	5
Very unsatisfied	unsatisfied	neither satisfied nor unsatisfied	satisfied	very satisfied

Q2. My abilities and opinions at the board table are respected and genuinely valued by the Entrepreneur

1	2	3	4	5	6
Strongly disagree	disagree	neither agree nor disagree	agree	strongly agree	no board position held

Q3. Generally speaking, conditions in the contractual agreement between the venture company and my firm are reasonable and fair. (Conditions include for example - designated responsibilities and roles, control/ decision-making authority, processes for appointment of staff/board members, etc)

1	2	3	4	5
Strongly disagree	disagree	neither agree nor disagree	agree	strongly agree

Q4. I am adequately consulted by the Entrepreneur' regarding important decisions which affect the venture company.

1	2	3	4	5
Strongly disagree	disagree	neither agree nor disagree	agree	strongly agree

Q5. I would rate the level of influence I have over the venture company's decision-making processes as

1	2	3	4	5
Very low	low	moderate	high	very high

Section H

Q1. Objectively speaking, I feel the overall level of monitoring (both informal and formal) of my actions and activities by the Entrepreneur is

1	2	3	4	5	6
Very low	low	moderate	high	very high	unsure

Q2. I feel the overall level of scrutiny of my decisions by the Entrepreneur is

1	2	3	4	5	6
Very low	low	moderate	high	very high	unsure

Q3. The frequency of board meetings is

1	2	3	4	5	6
Annually	bi-annually	quarterly	monthly	weekly	Sporadic

Q4. Have you or the Entrepreneur ever considered using legal action, or resorted to legal action to resolve a business conflict?

1	2
Yes	No

Q5. How effective do you believe the current governance arrangements within the venture company with respect to monitoring and controlling undesirable actions and behaviours on the part of the Entrepreneur?

1	2	3	4	5
very Ineffective	ineffective	moderately effective	effective	very effective

---

Section I

Q1. How many directors sit on the venture company's Board?

1	2	3
3 or less	4 - 5	more than 5

Q2. How many Board members are independent / external to the firm?

1	2	3
None	1 member	2 members or more

Q3. In the venture company, is the role of Chairperson of the Board and CEO held by the same person?

1	2
Yes	No

Section J

Q1. Overall, the level of cooperation on business-related matters between me and the Entrepreneur is

1	2	3	4	5
Very low	low	moderate	high	very high

Q2. Do you believe the Entrepreneur displays generally self-interested behaviours with respect to their involvement in the business?

1	2
Yes	No

Q3. I have a social relationship with the Entrepreneur that extends beyond a purely business relationship. (i.e. you regularly interact with the Entrepreneur outside of working hours and in a context that is mostly social)

1	2
Yes	No Go to Q5

Q4. Did you have a personal relationship with the Entrepreneur prior to engaging in the current venture?

1	2
Yes	No

Q5. The Entrepreneur holds similar work values to those held by myself.

1	2	3	4	5
Strongly disagree	disagree	neither agree nor disagree	agree	strongly agree

Q6. Were I to have acquainted myself with the Entrepreneur outside of our business relationship, I think it unlikely a friendship would naturally have developed.

1	2	3	4	5	6
strongly disagree	disagree	neither agree nor disagree	agree	strongly agree	irrelevant due to existing friendship

Q7. Generally speaking, equality of control over business decisions exists between the Entrepreneur and I, irrespective of shareholdings and formal rules.

1	2	3	4	5
Strongly disagree	disagree	neither agree nor disagree	agree	strongly agree

Q8. I feel control of the business being taken over by the Entrepreneur.

1	2	3	4	5
never	rarely	occasionally	regularly	all control lost to VP

Note: <u>Question 9</u> requires you to consider events at the commencement of the venture.

Q9. Please indicate which, if any, of the following measures were included in the contractual arrangements between yourself and the venture company at the commencement of the venture. (Circle as many options "A – H" as applicable)

A Preference anti-dilution provisions (i.e. VC shields himself against decrease in value of share holding in event of additional share issues)
B Ratchet provisions (i.e. performance-based increase/decrease of initial share holdings by either VC or Entrepreneur)
C Restraint of trade provisions against the Entrepreneur
D Employment contract (stating min. employment period or requiring annual re-appointment of Entrepreneur)
E Pre-emptive rights provisions (i.e. right of first refusal by either VC or Entrepreneur on partial share sale by either party)
F Milestone-based investment conditions (i.e. VC capital instalments conditional upon meeting of performance milestones)
G Share issue class divisions (i.e. different classes of shares issued to VC and Entrepreneur respectively)
H Preference positions (i.e. on dividends and return on capital)
I Decisions on key matters (i.e. requiring of VC approval)
J Limitation of Entrepreneur activities outside of company activities
K Board constitution
L Directors' duties (incl. Contracted protection clauses for VC Directors to act in interests of VC)
M None
N Uncertain

Q10. Were any changes to the original contract made after commencement of the venture?

1	2
Yes	No **Go to Q12**

Q11. Did the contractual changes correspond with deterioration in the business relationship between yourself personally and the Entrepreneur?

1	2
Yes	No

Q12. How common are generous behaviours in the business relationship between yourself personally and the Entrepreneur?

1	2	3	4	5
non existent	rare	infrequent	occasional	routine

Section K

Note: <u>Question 1</u> requires you to again consider events at the commencement of the venture.

Q1. Thinking back, how would you rate the level of trust between yourself and the Entrepreneur at the beginning of the venture?

1	2	3	4	5
very weak	weak	moderate	strong	very strong

Q2. Since the relationship started, you perceive the level of trust between the parties to have

1	2	3	4	5
greatly decreased	decreased	not changed	increased	greatly increased

Q3. Have you had a business relationship with the Entrepreneur prior to the current venture?

1	2
Yes	No **Go to Section L**

Q4. How influential was your previous business relationship with the Entrepreneur in deciding to engage *<u>again</u>* with them in the current venture?

1	2	3	4	5
no influence	little influence	moderate influence	strong influence	very strong influence

---

Section L

The following questions relate specifically to **Interpersonal Trust** and are therefore somewhat different in nature to the preceding questions.

For all the questions in this section, please circle your response on a scale of 1 to 5 using the following ratings:

1	2	3	4	5
strongly disagree	disagree	neither agree nor disagree	agree	strongly agree

Q1. I have faith in the technical abilities of the Entrepreneur

1 2 3 4 5

Q2. I believe the Entrepreneur is always honest and truthful in our dealings.

1 2 3 4 5

Q3. The Entrepreneur is sincere in his/her attempts to see my point of view.

1 2 3 4 5

Q4. The Entrepreneur can be trusted to make sensible decisions about the venture company's future.

1 2 3 4 5

Q5. I feel quite confident that the Entrepreneur will always try to treat me fairly.

1 2 3 4 5

Q6. The Entrepreneur would not be prepared to gain advantage by deceiving the Board of Directors.

1 2 3 4 5

Q7. If the Entrepreneur gave me a compliment I would question if they really meant what they said.

1 2 3 4 5

Q8. I would be able to confide in the Entrepreneur and know that he/she would want to listen.

1 2 3 4 5

Q9. I could always expect the Entrepreneur to tell me the truth.

1 2 3 4 5

Q10. I could talk freely to the Entrepreneur and know that they would want to listen.

1 2 3 4 5

Q11. The Entrepreneur would never intentionally misrepresent my point of view to others.

1 2 3 4 5

Q12. If the Entrepreneur didn't think I had handled a certain situation very well, he/she would not criticize me in front of other people.

1 2 3 4 5

Q13. If the Entrepreneur promised to do me a favour, he/she would follow through.

1 2 3 4 5

Q14. If the Entrepreneur were going to give me a ride somewhere and didn't arrive on time, I would guess there was a good reason for the delay.

1 2 3 4 5

Q15. If I had to catch a flight, I could not be sure the Entrepreneur would get me to the airport on time.

1 2 3 4 5

Section M

Q1. Considering your personal overall business relationship with the Entrepreneur, what is the level of trust between the two parties?

1	2	3	4	5
Very low	low	moderate	high	very high

Q2. Having now experienced a relationship with the Entrepreneur, at what level would you rate their overall trustworthiness?

1	2	3	4	5
Very low	low	moderate	high	very high

Q3. Do you think, in general business dealings, that other people consider you a trustworthy individual?

1	2
Yes	No

Q4. Generally speaking, in business, how important is trust for firms to succeed?

1	2	3	4	5
very unimportant	unimportant	moderately important	important	very important

Q5. Should circumstances arise and, given your experience with the Entrepreneur' in this instance, would you embark upon a similar venture capital financing relationship with him/her again?

1	2
Yes	No

End of Questions - Thankyou

APPENDIX C

Anthony Gibbons
[redacted]

11 September 2003

Company Name
Addressee
PO Box XX XXX
Auckland

RE: VENTURE CAPITAL RESEARCH QUESTIONNAIRE

I sent you a questionnaire pack within the last three weeks relating to my Masters Degree research with Massey University.

My topic of research examines the issue of trust between venture capital providers and entrepreneurs in their business relationships.

This research has significant practical application in determining how venture capital financed firms may improve their performance. The information sought is expected to be particularly useful in providing ways for industry participants to improve their relationships, and ultimately, venture success.

If you have already completed and returned your questionnaire, please disregard this follow-up letter.

Otherwise, may I take this opportunity to encourage your participation in my research.

The limited size of the venture capital industry in New Zealand means every returned questionnaire is valuable in its contribution to this study.

I am only too happy to be contacted at the above email address or phone number if further information is required.

I understand your time is valuable and appreciate your support.

Kind regards,

Anthony Gibbons

APPENDIX D

Anthony Gibbons
[redacted]nz

16 September 2003

Company Name
Addressee
PO Box XX XXX
Auckland

Dear Sir/Madam,

RE: VENTURE CAPITAL RESEARCH QUESTIONNAIRE

I'd like take the opportunity to thank you if you've responded to my research questionnaire already. As reiterated in the follow-up letter I sent to you, this research has significant relevance to participants in venture capital financing relationships.

If you have not yet had the opportunity to complete and return your questionnaires, I would still encourage you to do so. **Every** returned questionnaire is valuable and can have a significant impact upon the results of this research.

I will be commencing data analysis in relation to this project on the **22nd** of **September** and need to have all questionnaires in by this date.

Questionnaire-based research exercises usually depend on a satisfactory sample size for credibility. Research into the venture capital industry in New Zealand is automatically hamstrung by the small number of potential respondents, whether Venture Capitalists or Entrepreneurs.

The questionnaire will take approximately 20 minutes of your time to complete. If you haven't already returned your questionnaire, I implore you to do so.

As mentioned previously, the findings of my research will be available upon request. I am only too happy to be contacted at the above email address or phone number if further information is required.

Once again, I appreciate your support.

Kind regards,

Anthony Gibbons

APPENDIX E

Dear Sir/Madam,

I kindly request your participation in this study exploring venture capital/private equity financing in New Zealand.

This research comprises the thesis research component toward my Master of Business Studies Degree at Massey University, Albany.

I seek your support in this initiative. Venture capital/private equity is now seen as a vital component of New Zealand's quest for economic progress. This unique research is timely in its contribution to better understanding the role of venture capital/private equity in New Zealand and the way Entrepreneurs and investors interact.

Specifically, this research seeks to examine the issue of trust in venture capital-financed business relationships in New Zealand. It is hoped that, with your support, this research will provide valuable information, and act as a useful tool for investors and entrepreneurs alike.

Please confirm your eligibility for participation

To be eligible to participate in this study **your venture** must satisfy either of the following criteria.

1) If engaged in a **CURRENT Venture**, it must have been in a venture capital/private equity-financing relationship for **at least 6 months from the point of first-round financing**.

OR

2) If an **HISTORIC Venture**, the formal business relationship with the investor must have ended not more than **approximately two years prior** to the current time.

If your venture satisfies the above criteria, please continue on to the instructions page of the questionnaire. This section further outlines which individuals from your firm are eligible to complete the questionnaire.

Please complete and return questionnaires in the **pre-paid envelope supplied.**

Any inquiries in relation to this research can be directed to me personally, or my University Supervisor at the following contact points:

Anthony Gibbons (Researcher)
[redacted]

Ms Coral Ingley (Supervisor)
Massey University (Albany Campus)
Email: C.B.Ingley@massey.ac.nz
Ph: 09 443 9700 ext. 9572
Please return your completed questionnaire by no later than **Monday 15 SEPTEMBER 2003.**

Naturally your full privacy and confidentiality in this project is assured and you are under no obligation to participate.

Thank you for your interest and support in my research.

Yours sincerely,

Anthony Gibbons

APPENDIX F

ENTREPRENEUR QUESTIONNAIRE

Please read the following **INSTRUCTIONS** before answering the questionnaire

Who should complete the questionnaire?

This questionnaire should be completed by the person who…

IMMEDIATELY PRIOR to entering a formal financial relationship with the respective Venture Capitalist -

1) Held at least 15 percent equity in the firm

AND, UPON COMMENCEMENT of the relationship -

2) Held a role as executive director

NB:
The following instructions require that, in answering the questions, you only refer to roughly the present time for current ventures, and the final year of operations for historic ventures.

However, where the above-identified individual is not, or was not, still an executive director of the venture company during these periods, for whatever reason, they **remain the preferred person** to complete the questionnaire.

Where this person is not available, eligibility for questionnaire completion falls to their successor within the firm.

Note: Contingency where multiple persons are eligible from a single firm

In the event that more than one individual meets the above criteria for any single firm then eligibility for completing the questionnaire falls to the individual serving the longest period in the role of executive director, as outlined above.

If, in the event this still produces two or more individuals eligible to complete the questionnaire, selection becomes arbitrary and at the discretion of the individuals concerned.

The Questionnaire

Relevant Time Period to Consider

When answering the questionnaire:

1) If referring to a **current venture** (i.e. a going concern) - Consider the relationship with your venture capitalist **ONLY AROUND THE PRESENT TIME**.

2) If referring to an **historic venture** (i.e. where the business relationship with the Venture Capitalist has already ended) – Consider the business relationship with your Venture Capitalist in its **FINAL YEAR OF EXISTENCE**.

Question Format

Various question and statement formats are used in this questionnaire.

Where a statement is made, you are required to indicate how much you either agree or disagree with the statement using a **1 to 5 numbered scale.** Please circle the number that best approximates your opinion.

Example **(1)**

1	2	3	4	5
strongly disagree	disagree	neither agree nor disagree	agree	strongly agree

In a similar fashion, other statements use a self-explanatory numbered scale to measure your opinion.

Example **(2)**

I feel the overall level of monitoring (both informal and formal) of my actions and activities by the VC is.

1	**2**	**3**	**4**	**5**
Very low	low	fair & reasonable	high	excessive

Things to know

4) The questionnaire is worded in every instance as though referring to the present time for current ventures. If you are referring to an **historic venture** in your responses please think of the questions in the context of the last year of your venture's relationship with the Venture Capitalist. (see example (3)).

Example **(3)**

I *felt* the overall level of monitoring (both informal and formal) of my actions and activities by the VC *were.*

1	**2**	**3**	**4**	**5**
Very low	low	fair & reasonable	high	excessive

5) **Venture Capitalist** in the questionnaire is abbreviated to **VC**
6) **Venture Company** in the questionnaire refers to *your firm*. I.e. the firm being financed

Note: Your responses to the questionnaire require you to consider the relationship with your **VC**. In every instance, whenever the abbreviation "VC" is used, you are required to think of **the person** from the venture capital firm who either holds/held a position on your company's board, or if no such board position is/was held, then the person whom you consider/ed your main liaison during the venture.

This is necessary to put your thoughts into a personal context.

Confidentiality

Remember that your responses in this study are **strictly confidential** and that results will be aggregated with other questionnaires.

The results of this research are intended to better understand the venture capital industry, not single out individual business ventures for scrutiny. Therefore, there is no risk of your questionnaire responses being individually identifiable.

All completed questionnaires will be destroyed upon collation of their data.

Now please proceed to the start of the questionnaire.

Venture Capital Relationships– WHERE'S THE TRUST?
Entrepreneur Questionnaire

Section A

The venture you'll be referring to in this questionnaire is

O	O
Historic	Current
Go to Section B	**Go to Section C**

Section B
Historic Ventures Only

Q1. In what year did the official business partnership with the VC end?
(Circle appropriate number above the answer)

1	2	3
2001	2002	2003

Q2. How many years did your company have a financial relationship with he VC?
(circle the appropriate number) (round your response up or down to nearest number of years)

1	2	3	4	5
Less than 2 yrs	2-3 yrs	4-5 yrs	6-7 yrs	8 yrs +

Q3. In your opinion, the overall performance of the venture company at the completion of the business relationship with the VC was

1	2	3	4	5	6
very poor	poor	satisfactory	good	excellent	uncertain
					Go to Q5

Q4. How much responsibility do you assign the VC for your answer in Q4?

1	2	3	4	5
no responsibility	very little	moderate	most	full responsibility

Q5. Is the venture company still operating as a going concern?

1	2	3
Yes	No	Don't know
	Go to Q7	**Go to Q7**

Q6. Are you still actively involved with the venture company, either as an executive director or in a reduced capacity?

1	2
Yes	No
Go to Section D	

Q7. Did you leave the venture company during the term of the partnership with the VC?

1	2
Yes	No

Proceed to Section D

Section C
Current Ventures Only

Q1. How many years has your venture company been in a business partnership with the VC? (choose an answer nearest to the number of years)

1	2	3	4	5
Less than 2 yrs	2-3 yrs	4-5 yrs	6-7 yrs	8 yrs +

Q2. Are you still actively involved with the venture company, either as an executive director or in a reduced capacity?

1	2
Yes	No **Go to Q5**

Q3. In your opinion, the overall performance of the venture company at the current time is

1	2	3	4	5	6
very poor	poor	moderate	good	excellent	Uncertain Go to Section D

Q4. How much responsibility do you assign the VC for your answer in Q3?

1	2	3	4	5
no responsibility	very little	moderate	most	full responsibility

Please **Proceed to Section D**

Q5. In your opinion, the overall performance of the venture company immediately prior to your departure was

1	2	3	4	5	6
very poor	poor	moderate	good	Excellent	uncertain **Go to Section D**

Q6. How much responsibility do you assign the VC for your answer in Q5?

1	2	3	4	5	6
no responsibility	very little	moderate	most	full responsibility	uncertain

---

Section D
Entrepreneur Profile

Q1. Are you the founder of the venture company under consideration?

1	2
Yes	No

Q2. Have you previously founded other businesses?

1	2
Yes	No

Q3. Please indicate your gender

1	2
Male	Female

Q4. Please indicate your age during the period of the relationship with the VC under consideration.

1	2	3	4	5
Under 25yrs	25 – 30yrs	31 – 40yrs	41 – 50 yrs	Over 50 yrs

Q5. Please indicate your highest level of formal academic achievement (or nearest equivalent)

1	2	3	4	5	6	7
School Cert. (Fifth Form)	Sixth Form Cert.	Bursary	Tertiary Diploma	Bachelors Degree	Postgraduate Degree	Other tertiary qualification incl. Tech/trade qual.

Section E
Firm Profile

Note: When answering questions under this section, if referring to an **historic venture**, read the questions as though in your final year of business partnership with the VC or alternatively, your final year of personal involvement with the venture company altogether.

Q1. Please indicate your personal shareholding in the venture company .

1	2	3
less than 25%	25 - 50%	51% and above

Q2. Please indicate the percentage of share ownership held by the VC in your venture company.

1	2	3
less than 25%	25 - 50%	51% and above

Q3. Has the VC's share ownership in the venture company increased since the original partnership agreement?

1	2
Yes	No

Q4. Please indicate the size of your venture company in terms of total staff numbers. (Do not include yourself in this count)

1	2	3	4
5 staff & less	6 – 10	11 – 49	50 and over

Q5. Please indicate the size of your venture company by annual turnover/income. Use the last available year of indicators nearest the period of the relationship with the VC under consideration.

1	2	3	4
less than $1 million	$1 million - $5 million	$5 million - $10 million	more than $10 million

Q6. Please indicate industry category which best approximates that in which your venture company operates (circle letter beside appropriate category)

A	Agriculture, Forestry and Fishing
B	Mining
C	Manufacturing
D	Electricity, Gas and Water Supply
E	Construction
F	Wholesale Trade
G	Retail Trade
H	Accommodation, Cafes and Restaurants
I	Transport and Storage
J	Communication Services
K	Finance and Insurance
L	Property and Business Services
M	Government Administration and Defence
N	Education
O	Health and Community Services
P	Cultural and Recreational Services
Q	Personal and Other Services
R	Other

Source: NZ Stat's (ANZSIC96)

Section F

Q1. The personal communication between the VC and me is open and honest.

1	2	3	4	5
Strongly disagree	disagree	neither agree nor disagree	agree	strongly agree

Q2. The frequency of personal communication between the VC and me outside of board meetings is

1	2	3	4	5
never	infrequent	occasional	frequent	routine

Q3. How free do you feel to discuss with the VC problems and difficulties you are experiencing in the venture company without jeopardizing your relationship or having it "held against" you later?

1	2	3	4	5
No freedom	mostly lacking freedom	neither free nor lacking freedom	somewhat free	completely free

Section G

Q1. To what extent are you satisfied with the way the VC makes general decisions concerning the venture company? (e.g. unfair and considered-considered - fair & reasoned)

1	2	3	4	5
very unsatisfied	unsatisfied	neither satisfied nor unsatisfied	satisfied	very satisfied

Q2. My abilities and opinions at the board table are respected and genuinely valued by the VC

1	2	3	4	5
strongly disagree	disagree	neither agree nor disagree	agree	strongly agree

Q3. Generally speaking, conditions in the contractual agreement between the VC and my venture company are reasonable and fair. (Conditions include for example - designated responsibilities and roles, control/ decision-making authority, processes for appointment of staff/board members, etc)

1	2	3	4	5
Strongly disagree	disagree	neither agree nor disagree	agree	strongly agree

Q4. I am adequately consulted by the VC regarding important decisions which affect the venture company.

1	2	3	4	5
Strongly disagree	disagree	neither agree nor disagree	agree	strongly agree

Q5. I would rate the level of influence I have over the venture company's decision-making process as

1	2	3	4	5
Very low	low	moderate	high	very high

Section H

Q1. Objectively speaking, I feel the overall level of monitoring (both informal and formal) of my personal actions and activities by the VC is

1	2	3	4	5	6
Very low	low	moderate	high	very high	unsure

Q2. I feel the overall level of scrutiny of my decisions by the VC is

1	2	3	4	5	6
Very low	low	moderate	high	very high	unsure

Q3. The VC reviews my work performance during board meetings

1	2	3	4	5
never	rarely	occasionally	frequently	every meeting

Q4. The frequency of board meetings is

1	2	3	4	5	6
Annually	bi-annually	quarterly	monthly	weekly	Sporadic

Q5. Have you or the VC ever threatened to use, or resorted to legal action to resolve a business conflict?

1	2
Yes	No

Section I

Q1. Does the VC hold a board position in the venture company?

1	2
Yes	No

Q2. How many directors sit on the venture company's board?

1	2	3
3 or less	4 - 5	more than 5

Q3. What number of board members are independent of / external to the venture company?

1	2	3
None	1 member	2 members or more

Q4. Is the role of Chairperson of the Board and CEO held by the same person?

1	2
Yes	No

Section J

Q1. Overall, the level of personal cooperation on business-related matters between the VC and me is

1	2	3	4	5
Very low	low	moderate	high	very high

Q2. Do you believe the VC generally displays self-interested behaviours with respect to their involvement in the venture company?

1	2
Yes	No

Q3. I have a personal relationship with the VC that extends beyond a purely business relationship. (i.e. you regularly interact with the VC outside of working hours and in a context that is mostly social)

1	2
Yes	No

Q4. Did you have a personal relationship with the VC prior to engaging in the current venture?

1	2
Yes	No

Q5. The VC holds similar work values to those held by myself.

1	2	3	4	5
Strongly disagree	disagree	neither agree nor disagree	agree	strongly agree

Q6. Were I to have acquainted myself with the VC outside of our business relationship, I think it unlikely a friendship would naturally have developed.

1	2	3	4	5
Strongly disagree	disagree	neither agree nor disagree	agree	strongly agree

Q7. Generally speaking, equality of control over business decisions exists between me and the VC, irrespective of shareholdings and formal rules.

1	2	3	4	5
Strongly disagree	disagree	neither agree nor disagree	agree	strongly agree

Q8. I feel control of the business being taken over by the VC

1	2	3	4	5
never	rarely	occasionally	regularly	all control lost to VC

Note: Question 9 requires you to consider events at the commencement of the venture.

Q9. Please indicate which, if any, of the following measures were included in the contractual arrangements between you or the venture company and the VC at the commencement of the venture. (Circle as many options "A – H" as applicable)

A Preference anti-dilution provisions (i.e. VC shields himself against decrease in value of share holding in event of additional share issues)
B Ratchet provisions (i.e. performance-based increase/decrease of initial share holdings by either VC or Entrepreneur)
C Restraint of trade provisions against the Entrepreneur
D Employment contract (stating min. employment period or requiring annual re-appointment of Entrepreneur)
E Pre-emptive rights provisions (i.e. right of first refusal by either VC or Entrepreneur on partial share sale by either party)
F Milestone-based investment conditions (i.e. VC capital instalments conditional upon meeting of performance milestones)
G Share issue class divisions (i.e. different classes of shares issued to VC and Entrepreneur respectively)
H Preference positions (i.e. on dividends and return on capital)
I Decisions on key matters (i.e. requiring of VC approval)
J Limitation of Entrepreneur activities outside of company activities
K Board constitution
L Directors' duties (incl. Contracted protection clauses for VC Directors to act in interests of VC)
M None
N Uncertain

Q10. Were any changes to the original contract made after commencement of the venture?

1	2
Yes	No **Go to Q12**

Q11. Did the contractual changes correspond with a deterioration in the business relationship between yourself personally and the VC?

1	2
Yes	No

Q12. How common are generous behaviours in the business relationship between yourself personally and the VC?

1	2	3	4	5
Non-existent	rare	infrequent	occasional	routine

Section K

Note: Question 1 requires you to again consider events at the beginning of the venture.

Q1. Thinking back, how would you rate the level of trust between yourself personally and the VC at the beginning of the venture?

1	2	3	4	5
very weak	weak	moderate	strong	very strong

Q2. Since the relationship started, you perceive the level of trust between the parties to have

1	2	3	4	5
greatly decreased	decreased	not changed	increased	greatly increased

Q3. Have you personally had a **business** relationship with the VC prior to the current venture?

1	2
Yes	No **Go to Section L**

Q4. How influential was your previous business relationship with the VC in deciding to engage *again* with the VC in the current venture?

1	2	3	4	5
no influence	little influence	moderate influence	strong influence	very strong influence

Section L

The following questions relate specifically to **Interpersonal Trust** and are therefore somewhat different in nature to the preceding questions.

For all the questions in this section, please circle your response on a scale of 1 to 5 using the following ratings:

1	2	3	4	5
Strongly disagree	disagree	neither agree nor disagree	agree	strongly agree

Q1. I have faith in the competence of the VC

1 2 3 4 5

Q2. I believe the VC is always honest and truthful in our dealings.

1 2 3 4 5

Q3. The VC is sincere in his/her attempts to see my point of view.

1 2 3 4 5

Q4. The VC can be trusted to make sensible decisions about the venture company's future.

1 2 3 4 5

Q5. I feel quite confident that the VC will always try to treat me fairly.

1 2 3 4 5

Q6. The VC would not be prepared to gain advantage by deceiving the Board of Directors.

1 2 3 4 5

Q7. If the VC gave me a compliment I would question if they really meant what they said.

1 2 3 4 5

Q8. I would be able to confide in the VC and know that he/she would want to listen.

1 2 3 4 5

Q9. I could always expect the VC to tell me the truth.

1 2 3 4 5

Q10. I could talk freely to the VC and know that they would want to listen.

1 2 3 4 5

Q11. The VC would never intentionally misrepresent my point of view to others.

1 2 3 4 5

Q12. If the VC didn't think I had handled a certain situation very well, he/she would not criticize me in front of other people.

1 2 3 4 5

Q13. If the VC promised to do me a favour, he/she would follow through.

1 2 3 4 5

Q14. If the VC were going to give me a ride somewhere and didn't arrive on time, I would guess there was a good reason for the delay.

1 2 3 4 5

Q15. If I had a flight to catch, I could not be sure the VC would get me to the airport on time.

1 2 3 4 5

Section M

Q1. Considering your personal overall business relationship with the VC, what is the level of trust between the two parties?

1	2	3	4	5
Very low	low	moderate	high	very high

Q2. Having now experienced a relationship with the VC, at what level would you rate their overall trustworthiness?

1	2	3	4	5
Very low	low	moderate	high	very high

Q3. Do you think, in general business dealings, that other people consider you a trustworthy individual?

1	2
Yes	No

Q4. Generally speaking, in business, how important is trust for firms to succeed?

1	2	3	4	5
very unimportant	unimportant	moderately important	important	very Important

Q5. Should circumstances arise and, given your experience with the VC in this instance, would you embark upon a similar venture capital financing relationship with them again?

1	2
Yes	No

Q6. Given your experience with the VC in this instance, would you again choose to use venture capital investment for any future financing needs?

1	2
Yes	No

End of Questions – Thankyou

APPENDIX G

VC and Entrepreneur Questionnaire Composition and Design

The questionnaires were composed of multiple sections, A through N. Each section was dedicated to obtaining a specific bundle of data.

Section A delineated venture types as either historic or current ventures and directed respondents toward either sections B or C. Inclusion of both historic and current ventures was intended to widen the base of venture experience from which to draw relevant data.

Sections B and C mirrored each other in two important questions. These related to perceptions of business performance in the entrepreneur/VC relationship and the apportionment of responsibility for this performance to the relational partner. Because the focus of the research was on perceptions and attitudes, quantitative business performance measures were thought unnecessary. The question of performance becomes one of deliberately broad generalisations, but more importantly *sets up* the following crucial question about apportionment of responsibility. VCs and entrepreneurs were expected to externalise blame for negative outcomes and vice versa for positive outcomes. Entrepreneurs in particular have been recognised to externalise negative outcomes (Baron, 1998). On the other hand, VCs can be expected to protect their industry reputations by avoiding acceptance of blame for failed or poorly performing ventures (Gawith et al., 2000). Externalising negative outcomes may be typical of many business organisations, including VCs, in order to maintain market credibility by avoiding perceptions of incompetence by the markets in which they operate.

Sections D and E elicited individual and venture profiles. The personal profiles in particular differed in the questions asked of VCs and entrepreneurs. This was to place different emphases on the variables of interest for each respondent. Questions asked of entrepreneurs emphasised quantitative characteristics; educational achievement, business experience, and so on. Such factors are presumed to influence the development of trust according to institution-based trust theory (Schumacher, 2001; Rousseau, 1998; Lewicki & Bunker, 1996). Further these factors are related to task performance, another determinant of trust (Costa et al., 2001).

Section F focused on communication. Only the final question in this series is adapted from another study. This question reads (Entrepreneur's questionnaire), "How free do you feel to discuss with the VC problems and difficulties you are experiencing in the firm without jeopardizing your relationship or having it held against you later?" (Roberts and O'Reilly, 1975). Otherwise, questions are derived from the literature that relates aspects of communication to trust. The effectiveness of communication between the VC and entrepreneur, particularly when related to aspects of procedural justice and feedback, are instrumental in determining the development of trust (Sapienza & Korsgaard, 1996). "Support for the relationship between communication and trust exists in both intra- and inter-organisational research" (Young-Ybarra & Wiersema, 1999, p.445).

***The trust development construct* (sections G, H, J, K, L)**

Section G relates to **Procedural Justice Theory**. The aim was to assess perceptions of "fairness", as distinct from the ingredients of fairness. This is an important distinction. Procedural justice creates perceptions of fairness when certain behaviours are exhibited. So if fairness is perceived, then the behaviours associated with procedural justice should be present. The perception of fairness is achieved through *representativeness, feedback* and *respect* according to Busenitz et al. (1998). The dimensions of the trust development construct used in this exercise include *feedback, open and frequent communication and* *consultative decision-making* (Korsgaard et al., 1995; Sapienza et al., 1996). The latter two explain the presence of representativeness and respect. Perceptions of fairness by subordinates toward their superiors contribute toward perceptions of trust within hierarchical relationships as purported by procedural justice theory.

Section H refers to **Agency Theory**. This section is distinct from the next section dealing with governance issues, despite including questions dealing specifically with governance-related matters, a manifestation of the agency problem. The sequence of questions in section H identifies a range of criteria that specifically query monitoring and control issues. However, there are two groups of questions here. The first group seeks perceptions of the level of monitoring and control directly. The second group explores Board procedures and rituals for tangible evidence of the level of monitoring and control within the entrepreneur/VC relationship.

As in most other sections, an attempt has been made in this section to approach each theoretical component relating to trust from multiple directions to enrich the data. A "bond-posting" subsection in section J, for instance, relating to the prisoner's dilemma has direct correlation also with agency issues. Bond-posting consists of various contractual covenants and safeguards, which impact the relationship in terms of risk reduction and control, both inherent features of agency theory (Cable & Shane, 19997). Whilst agency theory and prisoner's dilemma offer opposing arguments to explain the presence of control and cooperation in venture capital relationships, consideration of both theoretical explanations is necessary to provide a balanced analysis of the data obtained.

Section I, as already mentioned, investigated **governance** arrangements of venture firms. Although not directly exploring the ingredients of trust relevant to the venture capital context, clearly governance arrangements are heavily related to this inquiry. Governance arrangements are both the result of, and an influence upon trust development in venture capital relationships. This section of the questionnaire sought a description of governance demographics in terms of the number of venture company directors and external directors, and also duality with respect the position of CEO and Board chairmanship.

Agency problems can be diminished with the inclusion of independent board members and separation of the roles of CEO and chairperson. Advantages typically associated with Board member independence are premised on member impartiality and disassociation of personal agendas. Dispassionate behaviour and decision-making may be assumed to contribute to more transparent and fair Board performance. In such circumstances, where the integrity of the forum is high, presumably the level of trust among board members may be also be high. If this reasoning is correct, significant relevance must be attributed to governance procedures in their determination of trust creation. And by consequence, the form of governance must also influence the manifestation of personal relationships among Board members. These considerations are important for assessing the development of trust in venture capital relationships.

Section J explored the **Prisoner's Dilemma** concept of trust development. This section contained more questions than most others due to theoretical complexity. This section was structured along the dimensions of the prisoner's dilemma perspective which explain the presence of entrepreneur/VC cooperative behaviours. Cooperative behaviours within relationships are expected to create trust. These dimensions consist of *venture tenure*, *open & frequent communication, social relationship, personal similarity* and *bonding mechanisms*. These dimensions were further reduced to equality of control, degree of self interest, previous personal relationships and values for example.

The prisoner's dilemma approach to explaining cooperation relies heavily upon the social exchange theory concept, examined in Section K. Dimensions of the approach that relate particularly to previous relationships and development of emotional bonds are explained effectively by social exchange theory (Rodriguez & Wilson, 2002; Young-Ybarra & Wiersema, 1999). The complexity of the prisoner's dilemma framework contrasts with the relatively concise groups of questions developed in the questionnaire. The sub-section on transaction procedures includes other subsets of criteria, including bond-posting, contractual arrangements and generous behaviours.

Social Exchange Theory was introduced into the questionnaire in **Section K**. The approach used for incorporating this theory was to identify a perceived level of trust at the commencement of ventures, changes to this level at a later stage and whether the parties shared a relationship prior to the current venture. Question 4 (see Appendices B & F) sought an indication of the level of influence of previous business relationships with current partners in deciding to engage in the current venture. The theory assumes that over time, through interaction, trust is inclined to develop through interdependence and relation-specific investments. Emotional bonds are anticipated to develop as the relationship moves through phases from being transactional and mostly economically inspired to one consisting of emotional bonds (Young-Ybarra & Wiersema, 1999). This explains the dimension, *tenure* used in the trust construct.

Familiarity of responses, behaviours and attitudes reduces risk in relationships, but also assists in developing interpersonal trust. Using a game theory approach, we can state that entry into the relationship by each party assumes some level of trust between relational parties, even if in very small quantities (Schumacher, 2001). This condition requires a mutual belief by each party that the other will not behave opportunistically in the first instance. Of importance is that the parties have to be *in* the relationship for trust to develop. Unless this initial base level of trust exists, the parties will not enter the relationship for fear of eventual loss (2001).

This particular section sought to confirm the major provisions of social exchange theory in the literature, applying these specifically to the venture capital-financing context.

Section L consists of questions relating to **Interpersonal Trust**. This is the only section where all the questions were drawn directly from existing data collection instruments. This approach was used for robustness of questionnaire design. A *cut and paste* method was used in selecting the questions from other instruments to be included. The questions drawn from other instruments to explore interpersonal trust had no implicit contextual bias. In other words, the questions were not specific to venture capital relationships or any other context.

The theoretical dimensions upon which the questions in this section were based consisted of *reliability & dependability, familiarity, benevolence/ability/integrity, open & frequent communication and cooperation* (see McAllister, 1995; Jen & Mannix, 2001, Herzog, 2001; Roy & Dugal, 1998, and Mayer et al., 1995).

Finally, **Section M** contained a group of questions which canvassed broad issues concerning venture capital financing and trust in the respondents' relationships. This was the only section in which respondents were required to provide an opinion about the level of trust in the overall relationship. Measurement of these opinions was undertaken using a five-point Likert scale in which respondents were simply asked about their perceived level of trust within the relationship (see Q1 in both VC and entrepreneur questionnaires in appendices). These broad responses were intended to consolidate the integrity of the design of the questionnaires. In explanation of this approach, particular response patterns within each completed questionnaire section carried implicit expectations of the level of trust in the entrepreneur/VC relationship. Cumulatively, the theoretically-based sections of individual questionnaires could be expected to indicate how much trust existed in any respondent's entrepreneur/VC relationship. Several questions in Section M of the questionnaires provided a simple, yet very useful indication of how effectively the questionnaires gauged the level of trust. This was effectively a process of theoretical and questionnaire design validation.

This section also sought to determine how the level of trust in venture capital relationships affects the individuals' future investment decisions. For instance, questions 4 and 5 of the entrepreneur questionnaires asked whether the respondent would re-engage with the same VC or any VC in the future. Similarly, question 5 in the VC questionnaires asked whether the respondent would re-invest with the same entrepreneur in future. Entrepreneurs' responses to these questions, in particular have important consequences for future use of venture capital in New Zealand. Entrepreneur perceptions about the New Zealand venture capital industry may rely on previous and current relationship outcomes. Widely held negative perceptions, for example, may diminish the reliance by entrepreneurs on this form of financing in future and negatively impact firm growth prospects.

APPENDIX H

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Entrepreneur Interview Guide Sheet (Version 1[13])

DATE:

Entrepreneur company name: XXXXXXX

Interviewee Name: XXXXXXX

- Business description – (Age / Stage of lifecycle/ board structure, etc)

- Performance of business over last 2 years

- Description of entrepreneur – (demographics / experience / motivation for business, etc – Observations)

[13] Version of guidesheet used at start of first round of entrepreneur interviews

Relationship with VC

- Quantitative – (length of relationship/ reason for finance / other financing options / referrals, etc)

- Qualitative - (Nature of relationship / good, bad – why / prominent features of relationship / problems / behaviours / examples of interaction)

Theory

- Agency theory
- Prisoners' dilemma theory
- Procedural justice
- Social exchange theory
- Interpersonal trust

Explore concepts – (relevance / application / practical experiences)

Trust

- Perceived importance

- Role?

- Description of trust in current relationship – (trust at start of venture / changes in trust)

- How created / how destroyed? (examples)

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Entrepreneur Interview Guide Sheet (Version 1[14])

DATE:

VC company name (if applicable): XXXXXXX

Interviewee Name: XXXXXXX

- Investor demographics – (experience / investment niche / qualifications / industry competitiveness / industry profile / investment term / required return, etc)

Investment model

- Deal finding process

- Deal structuring – (term sheet / contractual conditions / due diligence process)

[14] Version of guide sheet used at start of first round of VC interviews

- Governance – (reporting expectations / monitoring requirements / performance – milestone requirements / CEO replacement / penalties, etc)

- Deal making – (entrepreneur assessment approach – formal & informal / clincher attributes – killer attributes / relationship building)

Trust

- Agency theory
- Prisoner's dilemma
- Procedural justice
- Social exchange theory
- Interpersonal trust theory

Explore concepts – (relevance / application / practical experiences)

- Role of trust – (importance / role / trust creation? / trust destruction? – examples / relevance to venture performance

- Trust and governance – (trust vs monitoring & control / trust at start of venture / changes in trust vs changes in control) relationship of risk & trust

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Entrepreneur Interview Guide Sheet (Version 2[15])

DATE:

Entrepreneur company name: XXXXXXX

Interviewee Name: XXXXXXX

Relationship

1. How would you describe the relationship between yourself and the VC?
2. Describe the development of the relationship in terms of any bonds that may have developed since the start of the venture. How comfortable is the interaction?
3. What, if any, activities are undertaken by yourself and the VC to develop the personal relationship? (if so, how have they improved relationship?)
4. How would you describe the level of honesty, openness and trust in the relationship?
5. Has the development of these aspects changed (improved/deteriorated) over the course of the relationship? Give examples.
6. Do you feel respected by the VC in terms of your abilities and value to the venture? How do you know this?
7. How open (and frequent) is the communication between yourself and the VC?
8. How do you think the relationship between yourself and the VC has contributed to it current venture performance?
9. Explain how changes in the venture performance have impacted upon the relationship – both good and bad changes.
10. Have changes in venture performance impacted the feelings of trust between you and the VC? In what ways?

[15] Version of guidesheet used at start of second round of entrepreneur interviews

11. What behaviours and actions within the relationship do you think are most salient for creating and/or destroying trust? Why?
12. Describe the measures you might use to assess the level of trust in your relationship.

Tactics

1. How have you dealt with disagreements and/or disputes (if any) between yourself and the VC?
2. Is there any suspicion between yourself and the VC – describe
3. What would you do to get your way?
4. Describe the interaction between yourself and the VC at the board table.
5. If you perceived deterioration in either the performance of the venture and/or the relationship with the VC itself, what action would you take to improve the situation?

Structures

1. Which aspects of the governance arrangements in your business have been the most oppressive / beneficial?
2. Has the level of monitoring by the VC of your actions increased/decreased during the venture? Do you know why?
3. How has the level of monitoring affected the relationship, particularly concerning your perceptions of trust between yourself and the VC?
4. How effective do you believe the board meetings in contributing to the goals of yourself and the venture company? How could they be improved?
5. Do board meetings, by virtue of processes used increase the level of trust between the partners? How and why?

Behaviours

1. How do you ordinarily react to disagreements/disputes between yourself and the VC?
2. How does the VC react to disagreements/disputes in the relationship?

3. How big a part do your emotions play in the decisions you make in the venture? And the VC?
4. Do you consider yourself adequately consulted over venture decisions by the VC? (examples)
5. Is the VC fair?
6. Is the VC cooperative? Examples?

Traits

1. How would you describe your personality?
2. Do you think you react to events in an emotional or pragmatic (or combination) way?
3. How would you describe the personality of the VC? Do you find them a likeable individual?

Expectations

1. Has the VC delivered everything you expected from the relationship? (if not, in which areas?)
2. Has the interpersonal interaction between you and the VC been easier/more difficult that you expected? In what ways?
3. Have your partner's business abilities met your expectations? How, how not?
4. Who has control of the venture/ who calls the shots? Does this surprise you? Why?

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Entrepreneur Interview Guide Sheet (Version 2[16])

DATE:

Entrepreneur company name: XXXXXXX

Interviewee Name: XXXXXXX

Relationship

1. How would you describe the relationship between yourself and the Entrepreneur?
2. Describe the development of the relationship in terms of any bonds that may have developed since the start of the venture. How comfortable is the interaction?
3. What, if any, activities are undertaken by yourself and the Entrepreneur to develop the personal relationship? (if so, how have they improved relationship?)
4. How would you describe the level of honesty, openness and trust in the relationship?
5. Has the development of these aspects changed (improved/deteriorated) over the course of the relationship? Give examples.
6. Do you feel respected by the Entrepreneur in terms of your abilities and value to the venture? How do you know this?
7. How open (and frequent) is the communication between yourself and the entrepreneur?
8. How do you think the relationship between yourself and the entrepreneur has contributed to it current venture performance?
9. Explain how changes in the venture performance have impacted upon the relationship – both good and bad changes.

[16] Version of guidesheet used at start of second round of VC interviews

10. Have changes in venture performance impacted the feelings of trust between you and the entrepreneur? In what ways?
11. What behaviours and actions within the relationship do you think are most salient for creating and/or destroying trust? Why?
12. Describe the measures you might use to assess the level of trust in your relationship.

Tactics

1. How have you dealt with disagreements and/or disputes (if any) between yourself and the entrepreneur?
2. Is there any suspicion between yourself and the entrepreneur – describe
3. What would you do to get your way?
4. Describe the interaction between yourself and the at the board table.
5. If you perceived deterioration in either the performance of the venture and/or the relationship with the entrepreneur, what action would you take to improve the situation?

Structures

1. Which aspects of the governance arrangements in your business have been the most oppressive / beneficial?
2. Has the level of scrutiny by the entrepreneur of your actions increased/decreased during the venture? Do you know why?
3. How has the level of scrutiny affected the relationship, particularly concerning your perceptions of trust between yourself and the entrepreneur?
4. How effective do you believe the board meetings in contributing to the goals of yourself and the venture company? How could they be improved?
5. Do board meetings, by virtue of processes used increase the level of trust between the partners? How and why?

Behaviours

1. How do you ordinarily react to disagreements/disputes between yourself and the entrepreneur?
2. How does the entrepreneur react to disagreements/disputes in the relationship?
3. How big a part do your emotions play in the decisions you make in the venture? And the entrepreneur?
4. Do you consider yourself adequately consulted over venture decisions by the entrepreneur? (examples)
5. Is the entrepreneur fair?
6. Is the entrepreneur cooperative?

Traits

1. How would you describe your personality?
2. Do you think you react to events in an emotional or pragmatic (or combination) way?
3. How would you describe the personality of the entrepreneur? Do you find them a likeable individual?

Expectations

1. Has the entrepreneur delivered everything you expected from the relationship? (if not, in which areas?)
2. Has the interpersonal interaction between you and the entrepreneur been easier/more difficult that you expected? In what ways?
3. Have your partner's business abilities met your expectations? How, how not?
4. Who has control of the venture/ who calls the shots? Does this surprise you? Why?

APPENDIX I

VC Results

SECTION A

Status of the venture

Result	Frequency
Historic	1
Current	12
Total	13

SECTION B

In what year did formal partnership end

Result	Frequency	Percent
2002	1	
Total	1	100

Number of years in formal relationship with venture company

Result	Frequency	Percent
4 – 5 years	1	
Total	1	100

Overall venture performance (historic ventures)

Result	Frequency	Percent
Poor	1	
Total	1	100

Responsibility of entrepreneur for performance (historic ventures)

Result	Frequency	Percent
Most responsibility	1	
Total	1	100

Is the venture company still operating as a going concern?

Result	Frequency	Percent
no	1	
Total	1	100

SECTION C

No. of years of business partnership between VC and venture company

Result	Frequency	Percent
Less than 2 yrs	5	38.5
2-3 yrs	6	46.2
4-5 yrs	1	7.7
Total	12	92.3
Missing (1 historic)		100

VC's perception of overall venture performance (current ventures)

Result	Frequency	Percent
Very poor	1	7.7
Poor	4	30.8
Moderate	2	15.4
good	5	38.5
Total	12	92.3
Missing (1 historic)		100

Perceived responsibility of entrepreneur for performance

Result	Frequency	Percent
No responsibility	1	7.7
Very little response	1	7.7
Mod. responsibility	3	23.1
Most responsibility	5	38.5
Full responsibility	2	15.4
Total	12	92.3
Missing (1 historic)		100

SECTION D

Number of years VC involved in venture capital industry

Result	Frequency	Percent
Less than 3 yrs	4	30.8
3-5 yrs	3	23.1
more than 5 yrs	6	46.2
total	13	100

VC has personal experience running a business

Result	Frequency	Percent
Yes	9	69.2
no	4	30.8
total	13	100

Typical number of investments in VC's portfolio

Result	Frequency	Percent
0	1	7.7
2-5	6	46.2
more than 5	6	46.2
total	13	100

SECTION E

VC's level of participation in venture company

Result	Frequency	Percent
No participation	1	7.7
Moderately active	7	53.8
Very active	5	38.5
total	13	100

VC holds board position in venture company

Result	Frequency	Percent
yes	13	100
total	13	100

VC's contribution to strategy development at Board level

Result	Frequency	Percent
Moderate contributn	5	38.5
Heavy contribution	6	46.2
Full strategic decision making control	2	15.4
total	13	100

VC's perception of entrepreneur's managerial competence

Result	Frequency	Percent
Very poor	2	15.4
Poor	5	38.5
Moderate	3	23.1
Good	2	15.4
Excellent	1	7.7
total	13	100

VC's perception of entrepreneur's reliance on their input for venture success

Result	Frequency	Percent
Completely reliant	2	15.4
Mostly reliant	4	30.8
Somewhat reliant	5	38.5
Not reliant	1	7.7
Too difficult to know	1	7.7
total	13	100

SECTION F

Personal communication between self and partner is open and honest

Result	Frequency	Percent
Strongly disagree	1	7.7
Disagree	1	7.7
Neither agree nor disagree	4	30.8
Agree	4	30.8
Strongly agree	3	23.1
total	13	100

Frequency of communication between VC & entre outside board meetings

Result	Frequency	Percent
Never	1	7.7
Infrequent	3	23.1
Occasional	1	7.7
Frequent	6	46.2
Routine	2	15.4
total	13	100

VC's feeling of freedom to discuss venture-related issues with entrepreneur

Result	Frequency	Percent
Mostly lacking freedom	3	23.1
Neither free nor lacking freedom	2	15.4
Somewhat free	3	23.1
Completely free	5	38.5
total	13	100

SECTION G

VC's satisfaction with entrepreneur's decision making

Result	Frequency	Percent
Very unsatisfied	2	15.4
Unsatisfied	4	30.8
Neither satisfied nor unsatisfied	3	23.1
Satisfied	3	23.1
Very satisfied	1	7.7
total	13	100

V's abilities and opinions at Board table respected by entrepreneur

Result	Frequency	Percent
Strongly disagree	1	7.7
Disagree	1	7.7
Neither agree nor disagree	3	23.1
Agree	5	38.5
Strongly agree	3	23.1
Total	13	100

VC believes the contact between them & the entrepreneur is fair and reasonable

Result	Frequency	Percent
Strongly disagree	1	7.7
Agree	8	61.5
Strongly agree	4	30.8
total	13	100

VC is adequately consulted by entrepreneur regarding decisions

Result	Frequency	Percent
Strongly disagree	1	7.7
Disagree	2	15.4
Neither agree nor disagree	1	7.7
Agree	8	61.5
Strongly agree	1	7.7
total	13	100

VC's level of influence over decision making process

Result	Frequency	Percent
Low	2	15.4
Moderate	3	23.1
Hight	5	38.5
Very high	3	23.1
total	13	100

SECTION H

Entrepreneur's level of monitoring VC (formal and informal)

Result	Frequency	Percent
Moderate	6	46.2
High	4	30.8
Very high	3	23.1
total	13	100

Entrepreneur's scrutiny of VC's decisions

Result	Frequency	Percent
Low	1	7.7
Moderate	8	61.5
high	4	30.8
total	13	100

Frequency of venture company board meetings

Result	Frequency	Percent
monthly	13	100

VC claims either they or the entrepreneur have considered or used legal action to resolve venture conflict

Result	Frequency	Percent
Yes	5	38.5
No	8	61.5
total	13	100

Effectiveness of governance arrangement to monitor & control entrepreneur

Result	Frequency	Percent
Ineffective	2	15.4
Moderately effective	3	23.1
Effective	5	38.5
Very effective	3	23.1
total	13	100

SECTION I

No. of Directors on venture company board

Result	Frequency	Percent
3 or less directors	6	46.2
4-5 directors	5	38.5
more than 5 directors	2	15.4
total	13	100

Number of independent directors on venture company board

Result	Frequency	Percent
None	6	46.2
2 directors or more	7	53.8
total	13	100

Venture company Chairperson & CEO are the same person

Result	Frequency	Percent
Yes	2	15.4
No	11	84.6
total	13	100

SECTION J

Overall level of personal cooperation between VC & entrepreneur

Result	Frequency	Percent
Very low	1	7.7
Low	1	7.7
Moderate	6	46.2
High	4	30.8
Very high	1	7.7
total	13	100

Entrepreneur displays self-interested behaviours in venture

Result	Frequency	Percent
Yes	8	61.5
No	5	38.5
total	13	100

VC has a personal relationship with entrepreneur

Result	Frequency	Percent
no	13	
total	13	100

Entrepreneur holds similar work values to those of VC

Result	Frequency	Percent
Strongly disagree	1	7.7
Disagree	3	23.1
Neither agree nor disagree	5	38.5
Agree	3	23.1
Strongly agree	1	7.7
total	13	100

Unlikely that friendship between VC and entre would develop outside of venture

Result	Frequency	Percent
Disagree	1	7.7
Neither agree nor disagree	5	38.5
Agree	4	30.8
Strongly agree	3	23.1
total	13	100

VC & entrepreneur share equality of control over venture decisions

Result	Frequency	Percent
Strongly disagree	1	7.7
Disagree	5	38.5
Neither agree nor disagree	2	15.4
Agree	4	30.8
Strongly agree	1	7.7
total	13	100

VC regularly feels control of venture being taken over by entrepreneur

Result	Frequency	Percent
Rarely	3	23.1
Occasionally	3	23.1
Regularly	3	23.1
All control lost to other	4	30.8
total	13	100

CONTRACTUAL PROVISIONS

Preference anti-dilution provisions

Result	Frequency	Percent
Yes	6	46.2
No	7	53.8
total	13	100

Ratchet provisions

Result	Frequency	Percent
Yes	5	38.5
No	8	61.5
total	13	100

Restraint of trade against entrepreneur

Result	Frequency	Percent
Yes	11	84.6
No	2	15.4
total	13	100

Employment contract for entrepreneur

Result	Frequency	Percent
Yes	7	53.8
No	6	46.2
total	13	100

Pre-emptive rights provisions

Result	Frequency	Percent
Yes	11	84.6
No	2	15.4
total	13	100

Milestone-based investment conditions

Result	Frequency	Percent
Yes	6	46.2
No	7	53.8
total	13	100

Share issue class divisions

Result	Frequency	Percent
Yes	4	30.8
No	9	69.2
total	13	100

Preference positions

Result	Frequency	Percent
Yes	5	38.5
No	8	61.5
total	13	100

VC approval required on key decisions

Result	Frequency	Percent
Yes	11	84.6
No	2	51.4
total	13	100

Limitations on entrepreneur activities outside company

Result	Frequency	Percent
Yes	9	69.2
No	4	30.8
total	13	100

Board constitution

Result	Frequency	Percent
Yes	11	84.6
No	2	15.4
total	13	100

Director's duties specified

Result	Frequency	Percent
Yes	4	30.8
No	9	69.2
total	13	100

No contractual arrangements

Result	Frequency	Percent
Yes	0	0
No	13	100
total	13	100

Uncertain whether any contractual arrangements

Result	Frequency	Percent
Yes	0	0
No	13	100
total	13	100

Resume at QJ10

Changes in contract correspond with relationship deterioration

Result	Frequency	Percent
No	5	38.5
Changes made but no assoc. with deter.	8	61.5
total	13	100

How common are generous behaviours between VC & entrepreneur

Result	Frequency	Percent
Non-existent	3	23.1
Rare	2	15.4
Infrequent	4	30.8
Occasional	2	15.4
routine	2	15.4
total	13	100

SECTION K

Level of trust between VC & entrepreneur at start of venture

Result	Frequency	Percent
Weak	1	7.7
Moderate	7	53.8
Strong	3	23.1
Very strong	2	15.4
total	13	100

VC's perception of change in the level of trust since start of venture

Result	Frequency	Percent
Greatly decreased	4	30.8
Decreased	2	15.4
Not changed	3	23.1
Increased	4	30.8
total	13	100

VC & entrepreneur had business relationship prior to current venture

Result	Frequency	Percent
No	13	100
total	13	100

SECTION L

VC has faith in the technical abilities of the entrepreneur

Result	Frequency	Percent
Strongly disagree	1	7.7
Disagree	2	15.4
Neither agree nor disagree	2	15.4
Agree	5	38.5
Strongly agree	3	23.1
total	13	100

VC believes entrepreneur is always honest and truthful

Result	Frequency	Percent
Strongly disagree	2	15.4
Disagree	3	23.1
Neither agree nor disagree	2	15.4
Agree	4	30.8
Strongly agree	2	15.4
total	13	100

Entrepreneur is sincere in trying to see VC's point of view

Result	Frequency	Percent
Strongly disagree	1	7.7
Disagree	3	23.1
Neither agree nor disagree	5	38.5
Agree	1	7.7
Strongly agree	3	23.1
total	13	100

The entrepreneur can be trusted to make decisions about venture's future

Result	Frequency	Percent
Strongly disagree	3	23.1
Disagree	4	30.8
Neither agree nor disagree	3	23.1
Agree	1	7.7
Strongly agree	2	15.4
total	13	100

VC feels confident the entrepreneur will treat them fairly

Result	Frequency	Percent
Strongly disagree	1	7.7
Disagree	3	23.1
Neither agree nor disagree	5	38.5
Agree	1	7.7
Strongly agree	3	23.1
total	13	100

Entrepreneur would not deceive the board of directors

Result	Frequency	Percent
Strongly disagree	2	15.4
Disagree	3	23.1
Neither agree nor disagree	1	7.7
Agree	2	15.4
Strongly agree	5	38.5
total	13	100

If entrepreneur gave VC a compliment they'd question their motives

Result	Frequency	Percent
Strongly disagree	2	15.4
Disagree	5	38.5
Neither agree nor disagree	6	46.2
Agree		
Strongly agree		
total	13	100

VC could confide in the entrepreneur and know they'd want to listen

Result	Frequency	Percent
Strongly disagree	4	30.8
Disagree		
Neither agree nor disagree	5	38.5
Agree	1	7.7
Strongly agree	3	23.1
total	13	100

VC could expect the entrepreneur to always tell them the truth

Result	Frequency	Percent
Strongly disagree	2	15.4
Disagree	3	23.1
Neither agree nor disagree	4	30.8
Agree	2	15.4
Strongly agree	2	15.4
total	13	100

VC can talk freely with the entrepreneur who'd want to listen

Result	Frequency	Percent
Strongly disagree		
Disagree	1	7.7
Neither agree nor disagree	7	53.8
Agree	2	15.4
Strongly agree	3	23.1
total	13	100

The entrepreneur would never misrepresent VC's point of view to others

Result	Frequency	Percent
Strongly disagree	2	15.4
Disagree	2	15.4
Neither agree nor disagree	4	30.8
Agree	2	15.4
Strongly agree	3	23.1
total	100	100

The entrepreneur would not criticise the VC in front of others

Result	Frequency	Percent
Strongly disagree		
Disagree	3	23.1
Neither agree nor disagree	4	30.8
Agree	4	30.8
Strongly agree	2	15.4
total	13	100

The entrepreneur follows through with promised favours

Result	Frequency	Percent
Strongly disagree	1	7.7
Disagree	2	15.4
Neither agree nor disagree	3	23.1
Agree	5	38.5
Strongly agree	2	15.4
total	13	100

VC would assume entrepreneur has a good reason for any delay

Result	Frequency	Percent
Strongly disagree		
Disagree	1	7.7
Neither agree nor disagree	4	30.8
Agree	5	38.5
Strongly agree	3	23.1
total	13	100

VC could not be sure that the entrepreneur would get them to airport on time

Result	Frequency	Percent
Strongly disagree	3	23.1
Disagree	3	23.1
Neither agree nor disagree	6	46.2
Agree	1	7.7
Strongly agree		
total	13	100

SECTION M

Overall level of trust between VC and entrepreneur

Result	Frequency	Percent
Very low	2	15.4
Low	4	30.8
Moderate	3	23.1
High	2	15.4
Very high	2	15.4
total	13	100

Overall trustworthiness of entrepreneur

Result	Frequency	Percent
Very low	1	7.7
Low	2	15.4
Moderate	6	46.2
High	2	15.4
Very high	2	15.4
total	13	100

Do others consider VC trustworthy?

Result	Frequency	Percent
Yes	13	100
total	13	100

How does VC rate the importance of trust in business for success?

Result	Frequency	Percent
Important	3	23.1
Very important	10	76.9
total	13	100

VC would likely engage with the same entrepreneur again

Result	Frequency	Percent
Yes	5	38.5
No	8	61.5
total	13	100

APPENDIX J

Entrepreneur Results

SECTION A

All responses relate to current ventures – so no Section B

SECTION C

Number of years of venture partnership with VC

Result	Frequency	Percent
Less than 2 yrs	1	16.7
2-3 yrs	5	83.3
total	6	100.0

Entrepreneur is still actively involved with the venture

Result	Frequency	Percent
Yes	6	100
total	6	100

Entrepreneur's perceptions of overall present venture performance

Result	Frequency	Percent
Good	4	66.7
Excellent	2	33.3
total	6	100.0

Entrepreneur's claims of VC of responsibility for venture performance

Result	Frequency	Percent
Moderate response.	5	83.3
Most responsibility	1	16.7
Total	6	100.0

SECTION D

Respondent is the founder of the venture company

Result	Frequency	Percent
Yes	3	50
No	3	50
Total	6	100

The entrepreneur has founded other businesses

Result	Frequency	Percent
Yes	4	66.7
No	2	33.3
total	6	100.0

Gender of the entrepreneur

Result	Frequency	Percent
Male	6	100

Age of the entrepreneur

Result	Frequency	Percent
41-50 yrs	4	66.7
over 50 yrs	2	33.3
total	6	100.0

Highest level of academic achievement of the entrepreneur

Result	Frequency	Percent
Sixth form certificate	1	16.7
Graduate degree	0	0
Postgraduate degree	2	33.3
Other tertiary qual.	3	50.0
total	6	100.0

SECTION E

Entrepreneur's personal shareholding in the venture

Result	Frequency	Percent
Less than 25%	2	33.3
25-50%	4	66.7
total	6	100.0

VC's shareholding in the venture

Result	Frequency	Percent
Less than 25%	1	16.7
25-50%	4	66.7
51% and over	1	16.7
total	6	100.0

Any increase in VC ownership level since start of venture

Result	Frequency	Percent
Yes	2	33.3
No	4	66.7
total	6	100.0

Venture company size by staff number

Result	Frequency	Percent
5 staff or less	3	50.0
6-10 staff	1	16.7
11-49 staff	1	16.7
50 staff or more	1	16.7
total	6	100.0

Venture company size by turnover

Result	Frequency	Percent
Less than $1 million	4	66.7
$1 m - $5 million	2	33.3
total	6	100.0

INDUSTRY TYPE

Manufacturing

Result	Frequency	Percent
Yes	2	33.3

Education

Result	Frequency	Percent
Yes	1	16.7

Other

Result	Frequency	Percent
Yes	3	50.0

SECTION F

Communication between entre. & VC is open and honest

Result	Frequency	Percent
Agree	3	50.0
Strongly agree	3	50.0
Total	6	100.0

Frequency of communication outside of board meetings

Result	Frequency	Percent
Occasional	2	33.3
Frequent	2	33.3
Routine	2	33.3
Total	6	100.0

Sense of freedom by entrepreneur & VC to discuss issues

Result	Frequency	Percent
Somewhat free	2	33.3
Completely free	4	66.7
Total	6	100.0

SECTION G

Entrepreneur's level of satisfaction with VC's decision-making

Result	Frequency	Percent
Neither satisfied nor unsatisfied	1	16.7
Satisfied	1	16.7
Very satisfied	4	66.7
Total	6	100.0

The entrepreneur respects the VC's abilities and opinions

Result	Frequency	Percent
Agree	3	50.0
Strongly agree	3	50.0
Total	6	100.0

Entrepreneur believes the contract between them and VC is fair and reasonable

Result	Frequency	Percent
Agree	4	66.7
Strongly agree	2	33.3
Total	6	100.0

The entrepreneur feels adequately consulted regarding decisions by VC

Result	Frequency	Percent
Agree	2	33.3
Strongly agree	4	66.7
Total	6	100.0

The entrepreneur's perceived level of influence over venture decisions

Result	Frequency	Percent
Moderate	2	33.3
High	2	33.3
Very high	2	33.3
Total	6	100.0

SECTION H

VC's level of monitoring of entrepreneur's activities (formal and informal)

Result	Frequency	Percent
Moderate	4	66.7
High	2	33.3
Total	6	100.0

Perceived level of scrutiny by VC of entrepreneur business decisions

Result	Frequency	Percent
Moderate	2	33.3
High	3	50.0
Unsure	1	16.7
Total	6	100.0

The VC reviews my work performance during board meetings

Result	Frequency	Percent
Never	1	16.7
Frequently	4	66.7
Every meeting	1	16.7
Total	6	100.0

Frequency of venture board meetings

Result	Frequency	Percent
Quarterly	1	16.7
Monthly	4	66.7
Weekly	1	16.7
Total	6	100.0

Either entrepreneur or VC has threatened/used legal action to resolve conflict

Result	Frequency	Percent
Yes	1	16.7
No	5	83.3
Total	6	100.0

SECTION I

VC holds position on venture Board

Result	Frequency	Percent
Yes	6	
Total	6	100.0

Number of Directors on venture company Board

Result	Frequency	Percent
3 or less directors	3	50.0
4-5 directors	3	50.0
Total	6	100.0

Number of independent Directors on venture company Board

Result	Frequency	Percent
None	4	66.7
1 director	1	16.7
2 directors or more	1	16.7
Total	6	100.0

Chairperson and CEO are the same person

Result	Frequency	Percent
Yes	2	33.3
No	4	66.7
Total	6	100.0

SECTION J

The level of personal cooperation between the entrepreneur and VC

Result	Frequency	Percent
Moderate	1	16.7
High	2	33.3
Very high	3	50.0
Total	6	100.0

VC generally displays self-interested behaviours in venture

Result	Frequency	Percent
Yes	3	50.0
No	3	50.0
Total	6	100.0

The entrepreneur has a personal relationship with VC beyond venture

Result	Frequency	Percent
Yes	0	0
No	6	100.0
Total	6	100.0

Entrepreneur had personal relationship with VC prior to current venture

Result	Frequency	Percent
Yes	1	16.7
No	5	83.3
Total	6	100.0

Entrepreneur and VC hold similar work values

Result	Frequency	Percent
Neither agree nor disagree	1	16.7
Agree	4	66.7
Strongly agree	1	16.7
Total	6	100.0

A friendship between entre & VC outside of business relationship is unlikely

Result	Frequency	Percent
Strongly disagree	1	16.7
disagree	2	33.3
Neither agree nor disagree	1	16.7
Agree	2	33.3
Total	6	100.0

VC & entrepreneur share equality of control over business decisions

Result	Frequency	Percent
disagree	1	16.7
Neither agree nor disagree	1	16.7
Agree	3	50.0
Strongly agree	1	16.7
Total	6	100.0

Entrepreneur feels control of business being taken over by VC

Result	Frequency	Percent
Never	2	33.3
Rarely	3	50.0
occasionally	1	16.7
Total	6	100.0

CONTRACT PROVISIONS

Preference anti-dilution provisions

Result	Frequency	Percent
Yes	2	33.3
No	4	66.7
Total	6	100.0

Ratchet provisions

Result	Frequency	Percent
Yes	1	16.7
No	5	83.3
Total	6	100.0

Restraint of trade against the entrepreneur

Result	Frequency	Percent
Yes	3	50.0
No	3	50.0
Total	6	100.0

Employment contract for entrepreneur

Result	Frequency	Percent
Yes	2	33.3
No	4	66.7
Total	6	100.0

Pre-emptive rights provisions

Result	Frequency	Percent
Yes	4	66.7
No	2	33.3
Total	6	100.0

Milestone-based investment conditions

Result	Frequency	Percent
Yes	1	16.7
No	5	83.3
Total	6	100.0

Share issue class divisions

Result	Frequency	Percent
Yes	1	16.7
No	5	83.3
Total	6	100.0

Preference positions

Result	Frequency	Percent
Yes	1	16.7
No	5	83.3
Total	6	100.0

VC approval required on key decisions

Result	Frequency	Percent
Yes	5	83.3
No	1	16.7
Total	6	100.0

Limitations placed on entrepreneur activities outside of venture company

Result	Frequency	Percent
Yes	2	33.3
No	4	66.7
Total	6	100.0

Instalment of Board constitution

Result	Frequency	Percent
Yes	3	50.0
No	3	50.0
Total	6	100.0

Statement of Directors' duties

Result	Frequency	Percent
Yes	1	16.7
No	5	83.3
Total	6	100.0

Resumes at Q.J10

Any changes made to the venture contractual agreement after commencement

Result	Frequency	Percent
Yes	2	33.3
No	4	66.7
Total	6	100.0

Did the changes to contract correspond with deterioration in business relationship?

Result	Frequency	Percent
Yes	0	0
No	2	100.0
Total	2	100.0

Frequency of generous behaviours between entrepreneur and VC

Result	Frequency	Percent
Infrequent	1	16.7
Occasional	4	66.7
Routine	1	16.7
Total	6	100.0

SECTION K

Entrepreneur claims of the level of trust at start of venture

Result	Frequency	Percent
Moderate	1	16.7
Strong	2	33.3
Very strong	3	50.0
Total	6	100.0

Entrepreneur's perception of change in the level of trust since start of venture

Result	Frequency	Percent
Decreased	1	16.7
Not changed	1	16.7
Increased	3	50.0
Greatly increased	1	16.7
Total	6	100.0

Existence of business relationship between entre & VC prior to current venture

Result	Frequency	Percent
Yes	0	0
No	6	100.0
Total	6	100.0

SECTION L

Entrepreneur has faith in the competence of the VC

Result	Frequency	Percent
Neither agree nor disagree	1	16.7
Agree	3	50.0
Strongly agree	2	33.3
Total	6	100.0

Entrepreneur believes the VC is always honest and truthful

Result	Frequency	Percent
Disagree	1	16.7
Agree	2	33.3
Strongly agree	3	50.0
Total	6	100.0

VC is sincere in trying to see entrepreneur's point of view

Result	Frequency	Percent
Neither agree nor disagree	1	16.7
Agree	3	50.0
Strongly agree	2	33.3
Total	6	100.0

VC can be trusted to make decisions about the venture's future

Result	Frequency	Percent
Neither agree nor disagree	1	16.7
Agree	2	33.3
Strongly agree	3	50.0
Total	6	100.0

VC will always treat entrepreneur fairly

Result	Frequency	Percent
Neither agree nor disagree	1	16.7
Agree	2	33.3
Strongly agree	3	50.0
Total	6	100.0

VC would not deceive Board of Directors for own advantage

Result	Frequency	Percent
Neither agree nor disagree	1	16.7
Agree	1	16.7
Strongly agree	4	66.7
Total	6	100.0

Entrepreneur would question whether VC's compliments were genuine

Result	Frequency	Percent
Strongly disagree	1	16.7
disagree	3	50.0
Neither agree nor Disagree	1	16.7
Agree	1	16.7
Total	6	100.0

Entrepreneur could confide in their VC and know they'd listen

Result	Frequency	Percent
Neither agree nor disagree	1	16.7
Agree	3	50.0
Strongly agree	2	33.3
Total	6	100.0

Entrepreneur could expect VC to always tell them the truth

Result	Frequency	Percent
Neither agree nor disagree	2	33.3
Agree	2	33.3
Strongly agree	2	33.3
Total	6	100.0

Entrepreneur could talk freely with VC and know they'd want to listen

Result	Frequency	Percent
Neither agree nor disagree	1	16.7
Agree	4	66.7
Strongly agree	1	16.7
Total	6	100.0

VC would never intentionally misrepresent entrepreneur's point of view

Result	Frequency	Percent
Neither agree nor disagree	1	16.7
Agree	3	50.0
Strongly agree	2	33.3
Total	6	100.0

The VC would not criticise the entrepreneur in front of others

Result	Frequency	Percent
disagree	1	16.7
Agree	4	66.7
Strongly agree	1	16.7
Total	6	100.0

VC follows through with favours promised to the entrepreneur

Result	Frequency	Percent
Neither agree nor disagree	2	33.3
Agree	2	33.3
Strongly agree	2	33.3
Total	6	100.0

The VC would have a good reason for any delay in arrival

Result	Frequency	Percent
Neither agree nor disagree	1	16.7
Agree	4	66.7
Strongly agree	1	16.7
Total	6	100.0

Entrepreneur could not be sure that VC would get them to airport on time

Result	Frequency	Percent
Strongly disagree	1	16.7
Disagree	4	66.7
Agree	1	16.7
Total	6	100.0

SECTION M

Overall level of trust between entrepreneur and VC

Result	Frequency	Percent
Moderate	2	33.3
High	2	33.3
Very high	2	33.3
Total	6	100.0

Overall level of trustworthiness of VC

Result	Frequency	Percent
Moderate	2	33.3
High	2	33.3
Very high	2	33.3
Total	6	100.0

Entrepreneur thinks others consider them trustworthy

Result	Frequency	Percent
Yes	6	100.0
Total	6	100.0

Importance of trust in business relationships

Result	Frequency	Percent
Important	4	66.7
Very important	2	33.3
Total	6	100.0

Entrepreneur would engage with same VC again

Result	Frequency	Percent
Yes	6	100.0
Total	6	100.0

Entrepreneur would seek venture capital for future financing requirements

Result	Frequency	Percent
Yes	5	83.3
Missing value	1	-
Total	6	83.3

Data Collection and Analysis – Open Coding (Codes and Definitions)

Opening Coding Framework	Label Code	Label Title	Conceptual explanation / Description
Setting/context			
	CONTREL	Contractual reality	Contractual conditions may produce harsh outcomes but are part of the game
	INDSTRUC	Industry structure	VC industry demarcated by above and below the line VCs
	VCVAL	VC value	Entrepreneur dispute about the value of input to ventures by VCs
	VCMAN	VC Investment coordination	P/E investors limit concurrent venture no's to enable better hands-on management
	VCNET	VC networks	P/E venture finding relies heavily on informal networks
	ENTRANGER	Entrepreneur anger	Anger expressed by entre's toward VCs from bad experience. "Glorified loan sharks"
	ENTRDES	Entrepreneur desperation	Defensive attitude to explain failed venture with VC: "Hand was forced" (blame casting)
	VCFAILDEL	VC fails to deliver	VC fails to deliver expected expertise etc. – Resentment/blame from entrepreneur
	VCBDEXP	VC board experience	VC board experience important for successful venture outcomes
	VCDUEDIL	VC due diligence	Due diligence commitment by VC typically extensive
	INTGOSYM	Initial goal symmetry	Essential for venture progress – mostly pre-investment
	VCMINSH	VC minor share holding	Typical deal structure commences with minor VC shareholding in venture
	VCBDREP	VC board representation	Board representation by VC almost always
	VCPLAN	VC planning	VCs strategy always entails exit strategy
	POOREXP	Poor experience	VC inexperience feature of immature NZ industry
	CLEARWIN	Clear window	Best insight and vehicle for influence is at board level of venture firm
	CLEARSPLIT	Clear split between issues	All issues that arise during ventures are one of 2 categories. Easy fix / hard to fix
	VCSELF	VC role clarity	VCs struggle to define themselves and have divergent perspectives on industry form in NZ
	FLUID	Fluid industry	Immature industry subject to severe business cycle influence – VC now but maybe not tomorrow
	VCMODEL	Venture capital model	NZ experience approximates international financing model
	TRUSTGOOD	Everybody trust aware	All parties aware of important role of trust – but VCs in particular very self-interested
	VCVALUE	VC contribution value	Diversity of opinion among entres about true value provided by VCs to their ventures – hi expectns?
	DEATH	Relationship breakdown	Deterioration of relationship between VC & entrepreneur is common – related to poor venture perf.
	VCCV	VC credentials for credibility	Entrepreneur's faith in VC ability strongly influenced by credentials and previous bus. ownership
	VCDEAL	Vent fin. Deal similarity	There is little strategic/competitive advantage sought in deal structure within VC industry
Relationships			
	INFINT	Informal interaction	It's essential that VCs & entres can interact informally to build trust
	TRSTb4LEG	Trust before legal	Legal structures & tools cannot replace trust in relationships
	BC	Business conflict natural	All parties to deal must accept conflict is inherent to all business interaction
	VCPEACE	VC peace of mind	VCs rely on establishing trust at start of relationship to guide further decisions
	NOSUP	No surprises in relationship	In both parties best interest that the bus. Relationship clearly articulated at start
	JRESP	Joint responsibility	Both parties need to accept joint responsibility for successful relationship – cooperation
	FRUSTPER	Frustration by performance	Frustration at poor partner performance typical emotion
	M/I	Mission impossible	VCs & entres are different animals. Prima facie have little chance of workg together
	HOUSEORD	House in order	Conflict between entre bus. Partners add extremely difficult dimension to venture
	ENTACCEPT	Entrepreneur acceptance	Entrepreneurs can accept own business inadequacies when completely honest
	FACEACC	Faceless accountability	Entrepreneurs may express blame for problems at VC org. rather than at personal level
	ENTPRAG	Entrepreneur pragmatism	Entres typically pragmatic and accepting of VC involvement – financial motive only
	SIMVAL	Similar values	Perception common that similar values between VC & entre leads to trust
	FAIRRET	Fair return	Entre needs to see fair reward split with VC or prone to resentment

	KNOWBET	Know better	Entres have only moderate interest in developing deep personal relationship with VC
	TRSTCOM	Trust communication	Increase communication you increase trust
	VCBUB	VC bubble	Entre perception of limited VC understanding of venture diminishes trust
	EVIL	Entre hostility	Entrepreneurs take dim view of VCs – perceived as necessary evil: based on reality or presumption?
	PERSONAL	Interpersonal problems	Interpersonal problems between VC & entrepreneur are extremely destructive & difficult to resolve
	VCPOWER	VC power brokers	VCs perceive themselves as venture powerbrokers because they control the cash – arrogance?
	TRUSTCON	Trust consciousness	Neither VCs nor entrepreneurs seem particularly conscious of the role, importance & develop. of trust
	TRUSTRAT	Trust development strategy	No deliberate strategy to develop trust: VCs & entres happy just to get along: no higher value sought
	Agency	Agency theory awareness	Generally wide awareness of agency theory – though lacking detail and wider strategic implications
	Agency 2	Link between trust & monit.	Entrepreneurs understand the need for VC monitoring to build trust
	PROBSALL	Trst damaged in all relationship	All entrepreneurs report incident/s where VC behaviour had damaged the trust – emotive attitudes?
	Agency 3	Structure vs risk	Uncertainty of trust counterweighted by contract by VCs- Trust not significant due to artificial control
	Social1	Social exchange shallow	Limited interest by both VCs & entres to develop personal relationship– information exchange suffers
	PWER2VC	Power to the VC	Both VC AND entre think power in the relationship resides predominantly with the VC-formal control
	Social2	Min. necessary cooperation	Entres would only cooperate to the minimum required level with VC-only involve VCs as necessary
	Social3	Cooperation is trust	Perceived lack of cooperation by both VC and entre is typically viewed as breach of trust
	Inter1	Performance equal inter-trust	Perceptions of reliability & dependability (interpersonal trust) closely linked with venture performance
	Inter2	Comms affects inter-trust	Communication level is a crucial catalyst to impressions of reliability and dependability in partner
	BUILDING	Relationship building	Both VCs & entres capable of perceiving possible benefits from proactive relationship building activity
Interaction among actors			
	BESTBEH	Best behaviour	Suspicion at start of venture- little trust as all on "best behaviour"
	ENTBLAME	Entrepreneur blame	Entres commonly blame VC for poor venture results. Eg. "VCs no value to board"
	VCCOMP	VC competence	Entres think that VCs well-equipped to understand most venture issues
	PROBPRE	Problem predictability	Expect that problems in relationship are inevitable and constant
	VCOMNI	VC omnipresence	VCs may engage with firms at all levels – board and management
	GAMEPLAY	Gameplay and politics	Playing the game or politicking are essential skills to ensure progress
	VCWATCH	VC assessment of entre	VCs rate entre attitude as important to deal assessment & closure as due diligence
	LOCUS	Board locus of politics	Most politicking occurs at the board level – seat of interaction and power exertion – too formal?
	VCEXP	VC expertise doubts	Varying opinion about the management expertise from entrepreneurs
	Agency1	Level of monitoring	Variance between entres about the appropriate level of VC monitoring – perceptions not measurement
	TRDIESFIRST	Trust drops before remedy	Trust has generally deteriorated before VC implementation of controls – rather than as consequence
	PJ1	Consultation crucial	Both VCs and entres rate consultation as crucial to maintaining trust - fairness
	PJ2	Feedback	VCs often frustrated by paucity and tardiness of entre feedback
	PD1	Prisoners dilemma reciprocity	VCs and entres constantly looking for clues about relationship, often judged by reciprocity
	PD2	Snowballing bad relations	Poor reciprocity of positive behaviours reduces communication- parties withdraw from cooperation
	PD3	Generous behaviours limited	VCs & entres appear to minimize generous behaviours level necessary for relationship maintenance
	Social4	Equitable benefits	Entre resentful at VC reaping rewards of their hard work given VC input
	BOARDVAL	Value of board differs	VCs & entrepreneurs share difference of opinion of value of board meetings. VC value added?
	BRDAGENCY	Board relationship to trust	No clear evidence available of link between board meetings and development of trust
	CONTBAL	Contrl balance for confidence	Confidence in relationship (trust) is closely linked to perceptions of a control balance between VC & E
Strategies & tactics			
	VCPREP	VC deal preparation	VCs engage in tireless pre-investment inquiry and analysis
	VCEXP	VC experience for success	All concur that the level of VC experience often key determinant of venture success
	PRAGEMO	Pragmatism over emotion	Emotion erects barriers: problem recovery need pragmatism
	VCHBENCH	VC high benchmarks	VCs generally set high benchmark criteria targets in prospect ventures before investing
	INFASS	Informal assessment	Informal assessment of entre characteristics always occurs pre-investment.

	STOP	Stop deal if trust unsure	Insufficient pre-investment trust by VC in entre stops deal dead in tracks
	PERSPROF	Personality profiling	VCs avoid particular entre personality types – e.g. "control freaks"
	VCCRI	VC screening criteria	Assessment criteria includes people, product, place
	QUIKFIX	VC quick fix	CE replacement is commonly used VC solution to recurring venture problems
	VCHOWFIX	VC relationship solutions	VCs appear uncertain on solutions to resolve relationship problems
	CONFORM	Control by formality	When venture probs occur, solutions often require instigation of formal board process
	RESPONSE	Recovery by responsibility	When things go wrong both VC & entre must assume responsibility for finding solutions
	INTPOOR	Intuition poor mechanism	Indications of over-reliance by VCs on intuition for character judgement at start of venture
	ENTADM	Entrepreneur admission	Entrepreneurs seem willing to concede they may cause relationsp probs in some of their behaviour
	TRANS	Transparency to trust	Entres may build trust by ensuring all their actions are transparent to VC – avoids suspicion
	VCIMAGE	VC image management	VCs cautious to avoid being perceived as too controlling by entrepreneur –understand threats
	VCCOMMIT	VC level of commitment	Entres & VCs report differing levels of commitment to ventures – why?
	FIXONFLY	Personal probs fixed as-u-go	No pre-determined strategies for fixing relationship failure – only venture failure (formal mechs used)
	VCREACT	VCs reaction info short	Entres express frustration that VCs are quick to implement addition control without full information
	VCTOOLS	VCs restraint on punishment	VCs are well aware of the potential damage to relationship when decide to use contractual remedy
	MONITOR	VC monitoring level	Intensity of VC monitoring always increases when venture performance of concern
Consequences			
	ENTNAIVE	Entrepreneur naivety	Complacency/naivety, particularly in initial contract, can result in VC taking advantage
	VCDEP	VC dependency	Successful outcomes often depend on VC skill level – as proclaimed by VCs
	PPI	Poor performance indicator	A prominent indicator of poor venture performance is high CEO turnover
	BLAMEMAN	Blame management	VCs typically blame poor management for poor in venture performance
	CASH	Cash control	He who holds the cash has control
	DESTROY	Emotional destruction	Blame game kills relationship
	EMDEP	Emotional depletion	When entre's level of ownership/control depletes to low level – emotional & actual commitm't drops
	NWO	No way out	Some bad relationships cannot be fixed or resurrected
	ENTHIDE	Entrepreneur hides	When firm is in trouble – common strategy for entre is to conceal information from VC
	REGRET	Entrepreneur regret	Entes regret after failure: Delayed anguish & solution identification – should have been more assert.
	LINK	link performance with personal	Poor performance of venture generally concomitant with interpersonal relationship deterioration
Traits			
	ENTEMO	Entrepreneurs emotional	Entrepreneurs present as emotionally biased in assessment of venture and VC involvement
	VCSKILL	VC skill superiority	VCs express skill superiority over entrepreneurs – both overtly and covertly expression
	ENTIRR	Entrepreneurs irrational	See ENTEMO: VCs suggest entrepreneurs not always rational thinkers
	VCBIAS	VC bias toward entre skills	VCs routinely express low confidence in the skills and business acumen of entrepreneurs
	ENTSPEC	Entrepreneur specialization	VCs assert that entres predominantly technically skilled – often sole area of expertise
	VCDM	VC decision making	VCs assert their decision making is entirely pragmatic: It's not about control. Just good bus sense
	VCTHUMB	VC rule of thumb	VCs sceptical about relevance/usefulness of theory to resolving relationship disputes/problems
	VCOC	VC overconfidence	VCs very confident in own skills. Shirk trust theory in favour of intuition to resolve relationship probs
	VCNOCARE	VC orgs don't care	VCs (above line) are managers and share little emotional concern for venture success. Only fin. Retn
	VCWORLD	VC world	VCs (above line) described as bankers/lawyers/corporates who have no emot connection with entres
	VCKNOWALL	VCs skill set	Due to the small market in NZ (unsegmented) VCs need diverse range of skills
	VCBUS	VC business experience	VCs with previous experience running own businesses are better equipped for role
	LIFESTYLE	Entre lifestyle	Entrepreneurs view their businesses as providing opportunity to obtain lifestyle of choice
	ENTROB	Entres oblivious of incomp.	VCs think entrepreneurs are largely oblivious about their lack of skill – condescension by VCs

Data Collection and Analysis – Open Coding (Categories, properties and dimensions)

Label Code	Label Title	Categories	Properties/Sub-categories	Property dimensions
VCVAL	VC value			
ENTRANGER	Entrepreneur anger			
ENTRDES	Entrepreneur desperation		Accusation	Explicit - implicit
VCFAILDEL	VC fails to deliver			
FRUSTPER	Frustration by performance		Resentment	High - low
FACEACC	Faceless accountability			
FAIRRET	Fair return	Entrepreneur Reaction	Frustration	Explicit - implicit
ENTBLAME	Entrepreneur blame			
Social4	Equitable benefits		Emotion	Rational - irrational
PRAGEMO	Pragmatism over emotion			
VCREACT	VCs reaction info short		Cooperation	High - low
EMDEP	Emotional depletion			
ENTHIDE	Entrepreneur hides			
REGRET	Entrepreneur regret			
PRAGEMO	Pragmatism over emotion		Emotion	Rational - irrational
FRUSTPER	Frustration by performance			
VCSELF	VC role clarity	VC Reaction	Exert control	High - low
TRUSTGOOD	Everybody trust aware			
BLAMEMAN	Blame management		Cooperation	High - low
PRAGEMO	Pragmatism over emotion			
INTGOSYM	Initial goal symmetry			
CLEARSPLIT	Clear split between issues			
DEATH	Relationship breakdown			
M/I	Mission impossible			
Social1	Social exchange shallow			
Social2	Min. necessary cooperation			
Inter1	Performance equal inter-trust		Character match	Close - distant
Inter2	Comms affects inter-trust			
BUILDING	Relationship building		Emotion	Obstructive - irrelevant
PROBPRE	Problem predictability			
GAMEPLAY	Gameplay and politics		Commitment	Intense - flippant
VCWATCH	VC assessment of entre	Relationship		
PD2	Snowballing bad relations		Deterioration	Slow - rapid
VCPREP	VC deal preparation			
RESPONSE	Recovery by responsibility		Dominance (VC)	Destructive – inconsequential
VCCOMMIT	VC level of commitment			
FIXONFLY	Personal probs fixed as-u-go		Solutions	Effective - ineffective
CASH	Cash control			
NWO	No way out			

LINK	link performnce with personal			
VCSKILL	VC skill superiority			
VCWORLD	VC world			
VCCV	VC credentials for credibility			
VCPEACE	VC peace of mind			
NOSUP	No surprises in relationship		Surprises	Positive - negative
VCBUB	VC bubble			
Social3	Cooperation is trust		Impact	Positive - negative
Inter2	Comms affects inter-trust			
BESTBEH	Best behaviour	**Signals**	Meaning	Good - bad
Agency1	Level of monitoring			
PD1	Prisoners dilemma reciprocity		Strategic	Selfish - inclusive
CONTBAL	Contrl balance for confidence			
INFASS	Informal assessment		Clarity	Transparent - confusing
TRANS	Transparency to trust			
VCIMAGE	VC image management			
VCTOOLS	VCs restraint on punishment			
ENTBLAME	Entrepreneur blame			
ENTHIDE	Entrepreneur hides			
INFINT	Informal interaction			
JRESP	Joint responsibility		Blaming	Frequent - infrequent
PROBSALL	Trst damaged in all relationship			
Social2	Min. necessary cooperation		Formality	High - low
GAMEPLAY	Gameplay and politics	**Behaviours**		
PJ1	Consultation crucial		Destructiveness	Present - Absent
PD3	Generous behaviours limited			
TRANS	Transparency to trust		Cooperation	Common - uncommon
VCIMAGE	VC image management			
VCTOOLS	VCs restraint on punishment			
VCNOCARE	VC orgs don't care			
FAIRRET	Fair return			
CONTREL	Contractual reality			
INDSTRUC	Industry structure			
VCMAN	VC Investment coordination			
VCNET	VC networks		Pre-investment commitment	High - low
VCDUEDIL	VC due diligence			
VCMINSH	VC minor share holding		Fairness	High - low
VCBDREP	VC board representation			
VCPLAN	VC planning		Effect	Oppressive - benign
POOREXP	Poor experience			
CLEARWIN	Clear window		Formality	High - low
FLUID	Fluid industry			
VCMODEL	Venture capital model		Transparency	High - low
VCDEAL	Vent fin. Deal similarity	**Structures**		
TRSTb4LEG	Trust before legal		Trust facilitating	High - low

Agency	Agency theory awareness			
Agency 3	Structure vs risk		VC expectations	Excessive - benign
PWER2VC	Power to the VC			
BESTBEH	Best behaviour		Remedies	Destructive - constructive
BRDAGENCY	Board relationship to trust			
CONTBAL	Contrl balance for confidence		Monitoring	Oppressive - Acceptable
VCPREP	VC deal preparation			
VCHBENCH	VC high benchmarks		Control	VC - entrepreneur
INFASS	Informal assessment			
STOP	Stop deal if trust unsure			
PERSPROF	Personality profiling			
VCCRI	VC screening criteria			
QUIKFIX	VC quick fix			
CONFORM	Control by formality			
MONITOR	VC monitoring level			
ENTNAIVE	Entrepreneur naivety			
PPI	Poor performance indicator			
CASH	Cash control			
VCDM	VC decision making			
Social4	Equitable benefits			
BC	Business conflict natural			
ENTPRAG	Entrepreneur pragmatism			
KNOWBET	Know better			
VCBUB	VC bubble		Business outcomes	Equitable - inequitable
EVIL	Entre hostility			
TRUSTCON	Trust consciousness		Conflict	Typical - exceptional
TRUSTRAT	Trust development strategy			
Agency 2	Link between trust & monit.		VC contribution	Realised - unrealized
Social1	Social exchange shallow			
PWER2VC	Power to the VC		Relationship	Close - distant
Social3	Cooperation is trust			
Inter1	Performance equal inter-trust	**Expectations**	Cooperation	High - low
BUILDING	Relationship building			
VCCOMP	VC competence		Behaviour	Pragmatic - irrational
PROBPRE	Problem predictability			
VCWATCH	VC assessment of entre		Partner ability/skill	Excellent - poor
VCEXP	VC expertise doubts			
Agency1	Level of monitoring		Trust	High - low
BOARDVAL	Value of board differs			
CONTBAL	Contrl balance for confidence		Partner control	Dominant - subservient
VCHBENCH	VC high benchmarks			
VCCOMMIT	VC level of commitment			
ENTIRR	Entrepreneurs irrational			
VCBIAS	VC bias toward entre skills			
LIFESTYLE	Entre lifestyle			

REGRET	Entrepreneur regret			
M/I	Mission impossible		Partner fit	Good - bad
ENTACCEPT	Entrepreneur acceptance			
VCPOWER	VC power brokers		Partner behaviour	Pragmatic - irrational/emotional
INTPOOR	Intuition poor mechanism			
ENTADM	Entrepreneur admission		Partner ability	Excellent - poor
ENTEMO	Entrepreneurs emotional	**Traits**		
VCSKILL	VC skill superiority		Intuition	Reliable - unreliable
VCDM	VC decision making			
VCTHUMB	VC rule of thumb		VC compassion	High - low
VCOC	VC overconfidence			
VCNOCARE	VC orgs don't care			
VCWORLD	VC world			
ENTROB	Entres oblivious of incomp.			
VCREACT	VCs reaction info short			
BC	Business conflict natural		Reason	Justified - unjustified
HOUSEORD	House in order			
PERSONAL	Interpersonal problems		Interpersonal problems	Frequent - infrequent
PROBSALL	Trust damaged in all relationshp			
TRDIESFIRST	Trust drops before remedy	**Conflict**	Remedies	Effective - ineffective
PJ2	Feedback			
BOARDVAL	Value of board differs		Venture performance	Negative impact - no impact
CONFORM	Control by formality			
DESTROY	Emotional destruction		Personalities	Inflammatory - benign
LINK	link performance with personal			
VCBDEXP	VC board experience			
VCVALUE	VC contribution value			
VCCOMP	VC competence			
VCEXP	VC expertise doubts		VC ability	Excellent - ambiguous - poor
VCEXP	VC experience for success			
VCHOWFIX	VC relationship solutions		Entrepreneur ability	Excellent - ambiguous - poor
ENTNAIVE	Entrepreneur naivety	**Value Added**		
VCDEP	VC dependency		VC relationship skills	Excellent - poor
BLAMEMAN	Blame management			
VCBIAS	VC bias toward entre skills			
ENTSPEC	Entrepreneur specialization			
VCKNOWALL	VCs skill set			
VCBUS	VC business experience			
SIMVAL	Similar values			
TRSTCOM	Trust communication			
TRUSTCON	Trust consciousness		Intentions	Deliberate - oblivious
TRUSTRAT	Trust development strategy			
Agency 3	Structure vs risk	**Trust Development**	Personalities	Receptive - dismissive

Social3	Cooperation is trust			
VCWATCH	VC assessment of entre		Cooperative behaviours	Frequent - infrequent
TRDIESFIRST	Trust drops before remedy			
PJ1	Consultation crucial		Board processes	Pro-active - Reactive - oblivious
BRDAGENCY	Board relationship to trust			
RESPONSE	Recovery by responsibility		Manageability	High - low
FIXONFLY	Personal probs fixed as-u-go			
VCOC	VC overconfidence		Contract	Constructive – irrelevant - destructive
CONTREL	Contractual reality			
CLEARWIN	Clear window		Control	VC - equity - entrepreneur
VCOMNI	VC omnipresence	**Tactics**		
LOCUS	Board locus of politics		Board process	Transparent - hidden

Axial Coding

Paradigm Model Classification	Category Allocations
Causal conditions	Conflict, Structures
Phenomenon	Expectations, Relationship, Trust development
Intervening conditions	Signals, Traits, Value added
Action/ interaction strategies	Behaviours, Tactics
Consequences	VC reaction, Entrepreneur reaction

Example applications of axial coding to establish relationships between categories and phenomenon.

1.

Causal condition	*Phenomenon*	
Conflict	Relationship	
Properties of conflict	*Dimensions of relationship*	
• Reason	- Character match	Close
• Interpersonal problems	- Emotion	irrelevant
• Remedies	- Commitment	Intense
• Venture performance	- Deterioration	Slow (insignificant)
• Personalities	- Dominance (VC)	Inconsequential
	- Solutions	Effective

Context/ action strategies

Relationships with little or no conflict, as assessed against properties above, result in relationships that involve a close character match, irrelevant emotional influence, intense commitment by each party, slow or no deterioration, inconsequential VC dominance and effective implementation of solutions to problems. Under such conditions:

Interaction strategies used by VCs/entrepreneurs include fewer control behaviours, transparent board processes (tactics), infrequent blaming, low relationship formality, absent destructiveness and frequent cooperation (behaviours).

Intervening conditions

- (signals) "that" create few negative surprises, have a positive impact and meaning to both parties, exhibit inclusiveness & cooperation for strategic advantage and are transparent.
- (traits) "that" create a good fit between partners, exhibit pragmatic partner behaviour, indicate good partner business acumen & ability, and expression by VC compassion toward the entrepreneur's interests.

Consequences

- (Entrepreneur reaction) low resentment and high cooperation.
- (VC reaction) High cooperation and low exertion of control

2.

Causal condition	*Phenomenon*	
Structures	Trust development	

Properties of Structures	*Dimensions of trust development*	
• Strong pre-investment commitment	- Intentions	Oblivious
• Limited fairness	- Personalities	Dismissive
• Oppressive effect	- Cooperative behaviours	Infrequent
• Moderate Relationship formality	- Board processes	Reactive
• Mostly transparent	- Manageability	Low
• Moderately trust facilitating	- Contract	Destructive
• Excessive VC expectations		
• Destructive remedies		
• Oppressive monitoring		
• VC dominates control		

Context/ action strategies
Under conditions where the relationship is oblivious to trust development (no intentions), personalities are dismissive toward each other, cooperative behaviours are infrequent, board processes are reactive, manageability of the relationship is low and the contract is destructive, then:

Interaction strategies used by VCs/entrepreneurs include higher VC control and potentially less transparent board processes (tactics), frequent blame casting, high relationship formality, destructive behaviours with cooperation uncommon (behaviours).

Intervening conditions

- (signals) possible negative surprises with negative impacts and meaning; have a strategic intent of exclusive advantage. Signals may be both transparent *and* confusing to partner, depending on strategic intent of signaller.
- (traits) poor fit between partners, poor partner ability (unable to resolve conflict), and expression of low VC compassion.

Consequences

- (Entrepreneur reaction) mod - high by entrepreneur and low to moderate cooperation.
- (VC reaction) moderate cooperation and high exertion of available control

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