Academic Network in Entrepreneurship, Innovation and Finance

European Best Paper no. 9

Alliance or Investment?
- Exploring the relationship between Venture Capitalists and Entrepreneurs

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This paper has been submitted for the Gate2Growth Academic Network's European Best Paper Award in Entrepreneurship, Innovation and Finance

Submitted: 07/2005

2. Abstract

This article explores the alliance aspect of the relationship between venture capitalists (VCs) and entrepreneurs. The article starts by framing the discussion with the guidance of some established theories according to which the relationship between VCs and Es could be argued to be close to a pure investment (Jensen and Meckling 1976, Landström 1993, Copeland and Weston 1992). Following Arthurs and Busenitz (2003), it is argued that this dominant view of the VC-E relationship, based on agency theory, can be limited in certain aspects. The article then moves on to discuss how this approach contrasts with the view of the VC-entrepreneur relationship as an alliance between two parties, and specifically an alliance based on pooling resources to maximize the joint value of the parties (Wernefelt 1984, Das and Teng 2000, Eisenhardt and Schoonhoven 1996).

Besides pooling of resources, also learning and evolution (Doz 1996) have been highlighted as key characteristics of a successful alliance. According to this view, the way in which the two firms will maximize their joint value cannot fully be predetermined. The facilitation of learning and fairness are also central concepts in an emerging view on VC-entrepreneur research (Busenitz et al. 2004). The entrepreneurial subjects could here benefit from some of the latest views on alliance creation. Central in this view is early creating a shared vision and an understanding of the other party's business, while over time also creating an atmosphere of trust and joint accomplishment between the two parties (Seppälä 2004).

This article presents a model based on findings from a multiple case study research project. The empirical evidence for the model consists of contrasting cases (Yin 1994) from two high-technology clusters which are considered central in a European context (Spilling and Steinsli 2003) -namely Sophia Antipolis in France and the Helsinki region in Finland.

The article proposes that in certain contexts an evolutionary alliance view may be helpful in understanding the relationship between VCs and entrepreneurs. The article further suggests several key propositions, which bring forward ways in which the evolution can occur and of which the entrepreneur should be aware. As such, the article may be particularly valuable for entrepreneurs while planning and negotiating VC funding, while also extending the scholarly discussion into new areas.

3. Theory development

3.1 Introduction

Entrepreneurship is an increasingly central topic in today's academic and managerial literature. This has been accredited to the fact that entrepreneurship is not only of value to entrepreneurs, but rather it has implications on companies (e.g. through internal venturing) as well as on established and emerging national economies and their labor employment (Busenitz et al. 2003). Entrepreneurship can be characterized as an attempt to extract profits from a new venture influenced by risk and uncertainty (Amit et al. 1993). One of the key factors contributing to the success of a newly founded company is its ability to finance its further development. While financing can be obtained through loans or even positive cash flow from the beginning, an increasingly important source of financing is that of Venture Capitalists (VCs). Venture capital has become especially important for start-ups, who are engaging in a project of *"learning"* or *"innovation"*, where the risk of failure to gain back the initial investments is usually suggested to be 80% or over (Bergemann and Hege 1998).

A notable feature of venture capital compared with other forms of financing is that a VC often plays an important role in helping to manage and guide the company in which it invests (Steier 1998). As such, the relationship between the VC and the entrepreneur has become an increasingly important focus of the scholarly community. Whether this interest has resulted in articles related to status signaling and growth of entrepreneurs (Davila et al. 2003), the use of contracts and incentives in the relationship (Elitzur and Gavious 2003) or the effect on the performance of the start-up, the common denominator is to better understand the nature of this complex form cooperation between companies.

3.1.1 Motivation and aims

It is recognized that approaches close to agency theory has been used to explain the relationship between VCs and entrepreneurs. It has, however, also been suggested that such a view may be limited and that it would be beneficial to view the relationship as cooperation between two parties and reinstate the entrepreneur as the key focus of the research (Arthurs and Busenitz 2003). It is the aim of this article to explore this aspect further. By using a combination of established and recently emerged literature on strategic alliances, the aim of the article is to explore whether such an approach could be useful in explaining the relationship between VCs and entrepreneurs.

The article starts by an overview of the extant literature on the dominant views of the VC-entrepreneur relationship. It is followed by a synthesis of relevant literature on strategic alliances. The article then moves on to present the methods, findings and conclusions of eight case studies that have explored the relationship between VCs and entrepreneurs in differing contexts. Special focus is put on presenting the cases in sufficient detail, to ensure the quality and reliability of the findings. Finally, the articles ends by a discussion of the findings and conclusions.

3.1.2 Predominant research paths

Although not the only view, agency theory[1] is the dominant research paradigm of studies of the relationship between VCs and entrepreneurs (see e.g. Sapienza and Gupta 1994). Agency theory focuses on the relationship in which one or more persons (the principal(s)) engage another person (the agent) to perform some work on their behalf (Jensen and Meckling 1976), and the issues associated with this type of arrangements. Agency theory further tries to solve two problems: conflicts of goals and different attitudes towards risks, and the maximization of one parties interests on the cost of the other party, i.e. opportunistic behavior (Landström 1993 and Eisenhardt 1989). In the context of VCs and entrepreneurs it is often assumed that the VCs are the principals and the entrepreneurs are the agents.

Two typical agency problems in the relationship between VCs and entrepreneurs have been highlighted. The first, adverse selection, can occur when the VC invests money in a start-up in which it can not possibly know everything about (e.g. know whether the entrepreneurial team can actually do what they promise or plan to do). The second problem, moral hazard, concerns the problem that the VC often has less information than the entrepreneur about what is actually going on and that this may tempt the entrepreneur to act opportunistically (see e.g. Van Osnabrugge 1998 and 2000).

While agency theory remains a viable approach to understanding the relationship between VCs and entrepreneurs, recent studies (Lehtonen et al. 2004) have suggested different ways in which also the VC can act opportunistically. Besides this criticism, agency theory has also overall been criticized for giving a rather limited view of the relationship. In this view agency theory is useless when the goals of the VC and the entrepreneur are aligned (Arthurs and Busenitz 2003). As such cases could exist, it is in this article suggested that research should increasingly turn to the theories developed to explain inter-firm alliances.

3.1.3 Towards an alliance approach

An alliance can be described as "*any cooperative or joint action between two companies on a contractual and/or equity joint venture basis*" (Contractor and Ra 2000, p. 293) or e.g. as "*voluntary cooperative inter-firm agreement aimed at achieving competitive advantage for the partners*" (Das and Teng 2000, p. 33). As the relationship between VCs and entrepreneurs is likely to involve an inter-firm agreement, cooperative action and a joint goals (i.e. commercial success of the start-up, which brings financial value and recognition to both parties), it is surprising how little research has been devoted to this aspect to the VC-entrepreneur relationship.

One of the main theories to explain inter-firm alliances is the Resource Based View (RBV, see e.g. Barney 1991). According to this view, firms can identify certain resources, which can lead to high profits (Wernefelt 1984). As these resources are not necessarily found within the company, they need to be acquired externally, by e.g. forming an alliance with a party that possesses the resources. The RBV can further be developed into two views; the traditional RBV and the dynamic capabilities approach, which emphasizes the development of the resources through strategic learning (Mintzberg et al. 1998). While focusing on the development of resources through learning within the company, the

[1] Agency theory can further be divided into the normative (see e.g. Ross 1973 or Grossman and Hart 1983) and positivist (see e.g. Jensen 1983) approaches.

learning view is also highly interested in the process of learning, which occurs between companies that are sharing resources (Hamel and Prahalad 1990, Doz and Hamel 1998).

An emerging field in alliance related research is forming around the evolutionary dynamics[2] of the alliance processes (Ring 2000). In a seminal article, Doz (1996) argues for learning that occurs in certain aspects within in alliance. According to this view, it might not be possible for two parties entering into an alliance to nail down the exact way in which the alliance creates value or the way in which it should be optimally managed. More recently it has been argued that in fact this learning starts already before the alliance is operational and that there are a few key considerations that act a prerequisites for certain types of alliances. According to Seppälä (2004), creating an alliance involves the risk for inefficiencies, which can undermine the success of the alliance if not carefully considered. In his study, he suggests (Ibid, p. 160) that a combination of building trust, using pilot cooperation, understanding the other alliance party's business and an overall learning approach may help avoid the inefficiencies.

Following the discussion above, this article uses the description "*alliance*" or "*alliance-like*" in relation to VC-entrepreneur relationships which display either joint goals, pooling of resources, learning, trust or fairness, or a combination of several of these elements. This view is not entirely new, however. The view of "*soft*" notions such as trust, social links and fairness has been emerging also into the field of research of the relationship between VCs and entrepreneurs (see e.g. Sapienza and Korsgaard 1996 and Lind and Tyler 1998). It has further been suggested that "*procedural justice is positively associated with long-term venture performance, which suggests that VCs and NVTs may be well served by establishing procedures to ensure fairness and efficient information exchange….If VCs were perceived as treating [entrepreneurs] unfairly, that perception alone could preclude [entrepreneurs] from sharing their most critical insights as a covert way of negotiating for fairer treatment*" (Busenitz et al. 2004, p. 803-804). This view is well aligned with the approach to alliances discussed above. Whereas this relational view on VCs and entrepreneurs looks at the perceived fairness of the relationship, alliance related studies have found evidence that such fairness can be facilitated through analysis, habituation and learning. As such, it is interesting to consider whether the academic field of entrepreneurship can learn from the more established field of alliance research. The next section introduces the methods and data chosen to examine how this dialogue between the two fields can be found.

3.1.4 Methods and data

Entrepreneurship as a field of research remains in a theory-building stage (Wiseman and Skilton 1999). While the field has experienced a vast growth in the number of studies published, studies of varying nature is still need to build the field into a legitimate part of the managerial academic discipline of its own (Busenitz et al 2003).

There are two major approaches to creating scientific knowledge: deductive theory testing and inductive theory building (e.g. Bonoma 1985; Parkhe 1998). It is widely recognized that an inductive approach is better suited for a field of research, like entrepreneurship, which is still emerging (Yin 1994). According to Perry (1998, p.789), however, "*pure induction might prevent the researcher from benefiting from existing theory, just as pure deduction might prevent the development of new and useful theory*" [3]. As such, this study uses an inductive, iterative (Dubois and Gadde 2002) qualitative case study approach, as this approach is suggested to be a more realistic research paradigm in any research field, where some previous research has already been done.

While induction in its purest form has no questions to answer and no theories to test in the beginning of the process (Glaser and Strauss 1967), a study based on systematic combining is bound to have some early direction in which it is heading based on earlier research. In this study, this direction is represented by the following postulates:

[2] See e.g. Eisenhardt and Martin 2000 and Barnett and Burgelman 1996
[3] Few studies can be purely inductive, as noted by Strauss (1987, p. 253), as it is virtually impossible to ignore previous theory accumulated in one's mind before starting the research process, and in fact it may not even be desirable.

1) To look at the relationship between a VC and an entrepreneur solely from the view of the VC and/or guided solely by the theories related to agency problems may give a limited picture of the phenomenon
2) Focusing the research on the entrepreneur, and choosing both successful and unsuccessful cases of entrepreneurship may help find other aspects of the relationship to VCs.

Arthurs and Busenitz (2003) have argued strongly for the overrepresentation of studies on the relationship between VCs and entrepreneurs that have either directly or indirectly (through the choice of theoretical framework) focused on the VC. As such, this study has chosen entrepreneurs as the case objects.

This study examines eight start-ups, which have been chosen through a theoretical sampling logic (Yin 1994). The case start-ups have further beeen chosen so that they represent polar-types (successful, unsuccessful[4]) and different categories (across industries, IPO or non-IPO), which improves the quality of the study (Eisenhardt 1989). The case companies were located in two central European high-tech clusters (as suggested by e.g. Spilling and Steinsli 2003), namely the Helsinki region in Finland and Sophia Antipolis in France. Four cases - that had been highlighted by previous studies as very central in their respective regions- were chosen in both regions. Further, the sample of cases included one failed (bankrupt) and three existing companies in each of the regions.

The data for the study was gathered from three main sources. First, in-depth, semi-structured interviews were conducted with members of the entrepreneurial team. Second, data about the companies was gathered from company publications such as annual reports. Finally, press and literature searches were done to gather previous studies and press coverage of the case companies. Chronologically seen, some background data was gathered before the interviews, which were then followed by further rounds of data searches. This research approach allowed for triangulation of data (Jick 1979) and the possibility to go back and complete the gathered data based on newly emerged questions during the process (Dubois and Gadde 2002). The data analysis followed a mainly narrative approach, that was strengthened by realistic data, in a congruent approach close to critical realism (Patomäki and Wight 2000). The iterative data analysis process was started early on in the project and followed a path of first identifying case characteristics, then moving on the cross case comparison based on explorative matrices (Miles and Hubermann 1994). The last part of the analysis process consisted of drawing of conclusions based on the cross case data, while simultaneously building a chain of evidence between the data gathered, the findings and the conclusions, hence ensuring the validity and reliability of the study (Rowley 2002).

3.2 Empirical evidence

A summary of the eight case studies is provided below. Each individual description takes an inclusive approach to the representation of the cases (Gummesson 1991), by trying to offer not only a view on the studied phenomenon itself, but also a sufficient picture of the background of the company and the cooperation with the VC. Following what was said earlier about the emerging stage of the research field, it is here strongly argued that putting relatively much effort in presenting all the main aspects of the cases to the reader is vital. These aspects then serve as the building blocks of the main arguments presented later.

3.2.1 Case 1

Three young men founded Company 1 in May 2000. The founders knew each other from their studies they had finished not long ago. After their studies, the men had pursued careers in consulting, telecom and medical companies. Keeping close contact, the men met an evening in mid May 2000, as one of the founders recalls: "*We just met for beers to discuss where we wanted to go with our careers in the future. The evening ended in us coming up with and writing down the core of the company's strategy. Two-three weeks later we had all resigned from our current jobs to pursue the idea*". The company was officially founded the 31st of May 2000.

[4] Success is here defined according to growth and profitability targets set early in the project.

During the summer of 2000, the founders of Company 1 found an empty office of a local student union building and moved in. They soon hired two employees, which helped them develop early prototypes of their product. The idea was to make the product development process of medicines more efficient by utilizing electronical patient diaries that could be accessed by a mobile device. Because two of the founders had experience from the pharmaceutical industry, they knew the amount of information that had to be gathered and processed in a clinical trial of a new medicine. They thought that if they could help the pharmaceutical companies make the process more efficient and e.g. reduce the time-to-market for a new medicine, it could be a big business opportunity.

The founders used their own savings to get by the first months. "*We were 100% sure that this was a great business idea. We put in a lot of our own money, which in retrospect was probably a good thing. The internet bubble was bursting and the fact that we were so committed must have had a great impact on the decision to get financing in such an uncertain economic environment*". The entrepreneurs understood, however, that they could not get far with just their own money. During the summer, they started to develop a pilot version of their product and to contact VCs. The word of the company and its innovative idea spread fast, and soon it was not hard to get in contact with VCs. "*At some point a local VC called us, they had heard that we had a project and were looking for financing. We did not have many meetings before we agreed that we would do the contract with them instead of the other VCs we had talked to previously*". The VC that had contacted Company 1 was a relatively small VC, which had been very active in the local market during the recent years. The VC had some recent success stories, which were very impressive. In addition, the VC promised to be very active also in the future, as recalls one of the founders "*They also promised that their senior partners would participate heavily in building our business…For us it was very important to get a VC that provided also other things than money. As we were young guys, we realized that we did not know everything ourselves*." Company 1 signed the agreement of first round financing with the VC in august 2000. "*The senior partners of the VC had an entrepreneurial background, which we really saw was beneficial. They knew all the hard work that had to be done in the early phase….In the beginning we really were one big family*".

The money raised in the first round of financing, allowed Company 1 to develop its product both technically and commercially. Some time after continuing the development of the product, the management of Company 1 felt that to be close to its customers, it should set up and office in the USA. As the decision was made to set up a subsidiary in Boston, the VC offered one of its senior partners to live in Boston for some months, to help set up the US operations.

In February 2001, Company 1 closed the second round of financing. With the help of the initial VC, the company managed to get 3i, a large international VC to participate in the round. Company 1 soon found out, however, that the two VCs behaved quite differently. "*[3i] have been much more just like financiers. Of course, we have in some cases got valuable help from their global organization, but on a general level they are much more passive and distant than our initial VC*". The money raised in the second round allowed to further develop the offerings, and to find pilot customers.

In 2002, Company 1 made several commercial breakthroughs and finally closed a third round of financing (6,0 M€) in December 2002. This time, both of the existing VCs participated and they were joined by a third VC. At the time, the company was already employing over 70 people in several locations.

During the following years, the company continued its growth. As it was becoming to be recognized as one of the key players in its field, the company faced both publicity and tough competition. The entrepreneurial team, however, felt they had a strong strategy and kept pushing, without really making any big changes to it. In April 2004, Company 1 closed the fourth round of financing, with all of its existing VCs participating in the 2,75 M€ round.
Over the years, besides VC financing, the company has also received financing (in 2003 and 2005) from government programs that support the development of new, patentable technologies.

Today, Company 1 works with the majority of the world's 20 biggest pharmaceutical companies and has offices in Helsinki, Stockholm, London, Boston and on the US West Coast. The company's solution is globally considered one of the leading in its field (Company website 2005). According to one of the founders, the cooperation with the initial VC is still very good: "*It really is a win-win alliance, also now, over four years later*".

The original founders feel that the cooperation with the VCs, and especially the first round VC has helped them enormously. "*If I rank the importance of having good VC support*", says one of the founders "*I would say that most important is the team and its competences, second the business idea, but immediately after these two VC support as the third*." "*Maybe for us it has been quite easy, probably easier than for other companies*", the founder continues "*we have been in the lucky situation that we have been able to choose from several VCs in every round. Not all VCs have been available, but still the situation has been very good considering the economic down-turn in which the company was founded*".

3.2.2 Case 2

A man with a technological background and a vision for the development of the ICT sector, founded Company 2 in 1996. During the following years, the company developed some products, but with only moderate commercial success. In 2000, the company employed 3 people, and was looking for a way to grow faster. During the company's early years a friend of the original founder had followed the company quite closely, and even helped the company from time-to-time. Finally, as the company he was working for took an undesired new path, he joined the company as shareholder and CEO in 2000.

Company 2 wanted to concentrate on products instead of services. In 2000, the company had two main product lines, as the CEO explains. "*We had two product lines: on-line group collaboration suite, (email etc over web) and an on-line publishing solution. We really believed in our products, but we needed to focus. We scrapped the on-line publishing and decided to concentrate on the group collaboration product…As such, we decided that our core competence was in controlling the collaboration, not in the applications themselves. We decided that we would target telecom operators as tier one customers*".

While the company had existing clients and was growing organically, all of the shareholders agreed to focus on the development of one "*make or break*" product. This meant that the company was taking a risky path, and that it needed some outside financing. The company negotiated with several VCs during late 2000 and early 2001, and finally managed to get financing from a separate fund managed by a leading European venture capital company. The founders based their decision on the reputation of the company and the negotiation process itself. "*We got some good advice from many people that we should not look only at the money but also at the people they were bringing in. We negotiated with many parties but this VC had a nice package so we went with them without even negotiating with the others all the way….We liked that they were very professional. They kept deadlines, seemed objective etc. Our cooperation was right from the beginning very professional and pleasant*".

There was never question about how the money from the first round of financing would be used. During the next year, the company focused all its efforts on developing its single product. In late 2001, the product was beginning to be ready both technologically and commercially. During this time, the entrepreneurs had also agreed with the VCs to set up and an affiliate company in the APAC (Asia-Pacific) area, since many of its potential customers –i.e. telecom operators- were based in Asia.

Even if the company was progressing well, there were some dark clouds forming in the horizon. "*During 2001 the product was looking increasingly ready, but it was a big product which took time to complete. During this time we saw that the market started to shrink*". Since the company was really only developing one product, it was hard for it to fire only a part of its employees and e.g. develop only some aspect of the product. "*When we saw these problems, we started to look for a partner, that would be interested in our product. We found an American company, and we really proceeded well in our discussions during the summer and fall of 2001. I felt we had a real chance to strike a deal, where they would have invested in our technology, but there was the unfortunate terrorist attack, caused the negotiations to stop completely. After 9.11.2001 the negotiation failed, because the company was suddenly very cautious to do any overseas investments in this new business climate*".

The VC had helped Company 2 seek a partner, but after September 2001 it was hard even for a large, international VC to do anything to help the company. Finally, some weeks after the negotiation with the American partner had failed, the CEO called the VC managers and said that he and the team would be ready to file for bankruptcy. The VC managers agreed to this immediately, as the CEO recalls: "*Even when I phoned them and said that I would like to sign the bankruptcy papers, they agreed and behaved very professionally. They had a nice way of working and of course it also helped that I had a good personal relationship with the VC's contact person*".

Even in retrospect, the entrepreneurs of Company 2 look back at the cooperation with the VC with no hard feelings, even if the project failed. Both the original founder and the CEO stress this point: "*We strongly think that we had a sort of an alliance with the VC. We both knew what we were getting into. Taking risk really means taking risk. Even if we had a lot of contracts and term sheets, the whole activity was to jointly pursue a common goal*"

3.2.3 Case 3

In 1997 two young men were doing their military service in the same army unit. As they got to know each other better, they started to talk about what they wanted to do after they left the army, and realized that they had similar visions about the future. Both of them were seeing the changes in the ICT market that were caused by the increasing popularity of the mobile phone and short messages (sms) in particular. The two med invited a third young man, "*a friend with time, a vision and similar thoughts*" to join them. Together the men saw potential in providing sms-based services, which lead to the foundation of Company 3 in February 1998.

Company 3 soon had a lot of ideas it tried to realize with the help of sms, and as one of their first projects, they did a mobile version of the countries most popular online dating service. In the beginning, the company was quite self sufficient; they came up with an idea for a service, they programmed the necessary code, and then marketed it through various channels. "*We understood the market, i.e. the potential for sms services, in a way that was not widely spread at that time, so we came out with loads of new ideas all the time*", recalls the CFO of the company, who was also one of its founders. The market was about to change, however, and soon more traditional companies could come up with the ideas, but they needed Company 3 for technical development. The company started to increasingly base its business on services, which enabled other companies to publish their services in the wireless market.

"*In 1998-1999 we grew organically and had a quite nice cash flow*", says one of the founders "*at that time we were still only six employees, but because there were not many companies around at that time we started to get phone calls from VCs and business angels. The best weeks we had three or four VCs that wanted to come and meet us*". In 1999 the company finally chose a seed investor, Holden Capital, who put in 160 K€ for a 10% stake in the company, the amount of money was more or less the amount of turnover the company was making in that year. The sum seemed like a lot of money to the founders who were around 22 years old at the time, but soon they found themselves (lead by the seed investor) searching for additional VCs to complete the first round of financing.

In the year 2000, the company continued to grow. While most of the employees were occupied with product development, management together with the seed investor had found three VCs who were interested in investing money in the company. Of these three, Company 3 chose a local VC, which seemed to have a good track record. The first round of financing was finally closed so that the new investor put in 2 M€ for a valuation of 5 M€. The founders felt this was a nice deal since they were able to keep the majority of the company for themselves.

Over the next two years, the two investors kept pushing the company to grow internationally. This would have been ok, but the founders felt that there did not seem to be big growth in markets internationally. "*We kept saying no, but these guys had a long experience in the industry and were very convincing. In the end we had to agree*". In 2002, the company employed 55 persons and had offices in Finland, Sweden, Münich and Singapore. Company 3 had also bought a smaller company in its attempts to grow. The founders would have wanted to be more careful, since they saw that the money would run out if they continued to burn it at this pace, but they were ensured by the investors that additional funding would not be a problem. The CFO remembers that things started to become increasingly difficult, however: "*In 2002 we were running very short on money, and all of a sudden the VCs said that they would not put in more money into our operations*". As a result of radical changes in the market, the VCs were in a difficult position and could not keep their promises.

In the coming months, the company was trying to find a solution to the problem. The management and the investors were looking for possibilities to merge with other companies (the investors provided three rounds of very short bridge funding to make this possible), but the economic climate did not allow for such arrangements. Company 3 finally had to choose between bankruptcy and an insolvency process. The management decided to go through the insolvency process. This proved to be a very unpleasant process, as it proceeded in stages of about two months without guarantees about the next round.

During the insolvency, the company fired 43 people and the 12 people that were left lowered their salaries radically.

During the insolvency process Company 3 lost the majority of its customers. The management of the company was furiously looking for a solution, at this stage relatively unsupported by the financiers. After 14 months of insolvency process, the management found an American VC who agreed to invest enough money to bring the process to its end and the company back on its feet. The CFO of the company remembers that even if they had found a solution, it was not an easy decision to make "*The American VC agreed to buy us for a fraction of the previous valuation, and also wanted 51% of the company in return. This was our only way out of the process. Our old investors did not like the idea at all, and they had the right to say no, but they had to give in as there were no other options…Even today I'm amazed by the huge risk the American VC took. We were not even out of the insolvency process when they made their investment, and they could have lost all their money. The VC emphasized that they valued that management had hanged on in the hard times, and felt that this dedication was worth the risk*".

In January 2004, Company 3 could put the process behind it and refocused on business. The second and third quarter of 2004 were profitable, and the company is looking for new growth as the mobile industry is heading towards solutions enabled by new technology. During early 2005, the company has been able to close several significant new deals (Company 3 press release 2005). The CFO describes the relationship with the initial investors as bad. "*In the beginning, with the first seed investor cooperation was quite nice in the beginning, but with the other one we really never understood each other. Most of the times it has not even felt that we had the same goals with the VCs…Perhaps we did not understand how strongly they were driving towards an exit, when we were interested in building a business* ". As the company is looking towards a brighter future its management is thinking about what went wrong: "*we just felt betrayed. A good example is that we have not even seen the VC partner who sat on our board and forced the aggressive decisions since 2002. Instead, we have another guy who comes in and sits passively at the meetings. It is clear that we have not been interesting from their point-of-view for a long time*".

3.2.4 Case 4

Also Case 4 represents what seems to be a quite typical starting point for new start-ups. The initial business idea came up during a round of golf, as three young men were discussing potential to do business together. Among the three founders, two were students in a business school and one in an engineering school. Together they saw that that with the development of the internet, they could start offering up-to date stock data in this new media. Soon after the meeting on the golf course, in 1995, the three men founded the company, and successfully started to publish stock quotes on the internet.

In 1996, the newly founded company moved into the facilities of an incubator. As a part of the deal, the company received approximately 12 K€ to develop their business further (a sum "*which was not at all small for three young students*", as one of the founders recalls). Soon Company 4 had been selected as the provider of stock data for the website of the countries largest business newspaper. This was not an immense business, but it allowed the founders to work full time and develop the business further. In 1997, the company had several clients in its home country and tried to launch the same concept in neighboring countries, without any major successes. Even so, by 1998, the company was an important provider of electronical stock data, working with a vast majority of investment banks in its home country.

In 1998, Company 4 also started to experience the dot.com boom. The company had been selected as the provider of portfolio management and stock information solutions provider for a high-profile business portal. The portal deal had brought Company 4 publicity and with the publicity, the management team started to be contacted by various companies who wanted to either buy or cooperate with them. In 1998 one of the leading investment banks in the country offered to by the company. "*Our company was making a nice profit at the time, so we decided not to sell, but the idea of selling or finding a partner which could help us grow was something we started to consider*", recalls on of the founders. "*Also the business environment was increasingly turbulent during the hype, and it was hard e.g. to keep good employees who got ridiculously good offers in other dot.com companies*". The management team of Company 4 soon agreed to merge with another, bigger company. As a part of the arrangement, the founders would get a cash payment, but they would also get ownership and good positions in the new company.

The new company (here also referred to as Company 4) had an arrangement, in which the company was financially backed up by a parent company, which had created the new company to profit from the growing hype around internet services, and which was operating as a corporate VC towards the new Company 4. The VC was pushing strongly towards growth, by buying and merging smaller companies into Company 4. The goal of the VC was all along clear. The VC wanted to do an Initial Public Offering (IPO) of the company, which was something the three entrepreneurs agreed with, and started to working on in the new Company 4. "*We had a strong drive and a lot of work to do. I moved to London in 1998, because that was where we were going to list our company on the stock exchange*", says one of the founders. While the entrepreneurs agreed with the goal of the VC, they felt that the financial aid did not always follow, a consistent path, however. "*We were buying companies around Europe. There were many decisions I really did not feel comfortable with, and the financial means from the [VC] often came in small portions. It felt like bad planning, and was really a different world compared to before the merger, where we were taking all decision in our own company*".

During 1999, the company worked towards its goal, and finally in the end of 1999, (driven by and "*largely through the contacts of the VC*") the company did an IPO and the London new market stock exchange. The listing was considered a success, and the corporate VC achieved a partly exit from the company. The entrepreneurs felt increasingly at unease with how decisions in the company were made and the influence of the corporate VC, and one by one dropped out of the daily operations of the company.

During the following years, the company went through the dot.com market crash, which it barely survived. To cope with the challenges, the company did a number or restructurings, in which e.g. the original business of the founders of Company 4 –which remained profitable- was sold out of the company. Soon following this, as a result of various problems and a series of divestments, the company went bankrupt.

3.2.5 Case 5

When the CFO of Company 5 joined the company in July 1998, it had already been operational for almost three years. Even so, the company consisted only of three founders, with no offices or no staff whatsoever. Soon the company hired a secretary, however, and the CFO to facilitate the company's growth. The CFO had a background in several start-ups, and he was initially presented to Company 5 by a VC with whom he had worked before, and as such, he knew the company's history quite well.

The company was founded in 1996. Company 5 had a rather special outsourcing-based business model, as explained by the CFO: "*The company had a virtual business model, it only invested the money it had raised in early stage medical research in specialized research centers in different universities and organizations*". The company had been founded based on financing from three VCs in the first round of investment in 1996. The first round of investment brought in 2M€ for a valuation of 4,5 M€ (Company presentation 2004). The money was used totally for investments in medical research done by third parties. The cooperation and the deal making with the VCs was surprisingly varying for the company. "*With one VC we negotiated for a long time and they were very doubtful, we were their first biotech investment. Another was just asking a few questions and doing standard due diligence but much more easy.*" The company's CFO explains and continues: "*on the other hand, one VC even said that the valuation is too low, and wanted to raise the valuation. Another of our VCs would never have done this. They were negotiating the best deal possible and they were the ones who were very skeptical*". In 1997, the company did a second round of financing worth 6,3 M€, with a valuation of 27 M€ (Company presentation 2004). During the first years of Company 5's existence, the VCs supported the company by helping to analyze market trends, providing contacts to researchers around the world and by helping to recruit people. "*Our Swedish VC was very active, partly this is probably the company and its culture, but also because of the individual people involved*"

In 1998, the Company's existing VCs were pushing hard towards growth and an IPO. Not all VCs were active in they same way, however. "*Two of our three VCs have always been very active, while the third one is more 'sleeping.*". At one point during the hype years, one of the VCs even tried to persuade the company to try to take over an established, international pharmaceutical company with the help of Company 5's high valuation. "*The VC wanted us to buy this big company, but we had tough discussions and gave up the obviously ridiculous idea…*"

One thing the VCs managed to push the company to do – in full agreement with the management- was the successful IPO in November 1999. Preparing for the IPO, however, did create some tensions between the VCs and the management. "*The VCs wanted us to stop some medical experiments just before IPO, because they might have created uncertainty, but of course we had a business to develop and wanted to go on as usual. In the end we made some concessions, but still carried out with the initial development plans*".

During the post-IPO years, Company 5 experienced slightly less pressure from the VCs. With the new financing rounds directed at the public, in 2001 and 2004, the VCs were given a chance for gradual exit, which was of course their goal from the beginning. The CFO emphasizes that the success in the financing area of operations –the company has raised over 126 M€ of financing in total, public offerings included (Company presentation 2004)- with the VCs have been business as usual, but even so a business which requires a lot of skill. His experience with working with VCs has helped accomplished this. "*You have to understand the drivers and the incentives of the VC people and try to find a win-win common goal…the relationship between VCs and entrepreneurs is a normal business relationship. You have to have a cooperative attitude and e.g. communicate sufficiently to make it work*"

3.2.6 Case 6

The CEO of Company 6 had worked eight years in a major American ICT company before deciding to establish his own firm with one of his colleagues in 2002. During his time at the American company, he had become in charge of developing a platform for mobile phones. Over the years he and his colleague had seen that there would be a need to make the development of mobile software "*much more modular*", and based on this they together decided to quit the company and start a business that would explore this opportunity of "*an increasingly segmented, global market*" (Company presentation 2005).

While the two founders were exploring the market potential for their idea, they realized that their savings would not get them far, and that a regular salary was really a luxury. To be able to continue the analysis, they started to do consulting engagement on the side. This created a nice cash flow, but the founders "*did not want to go into this type of business in the long run*". After just a couple of months they found an investor. The investor was a VC (seed investor) that liked the idea and the skills of the two founders. There was only one problem. The VC would not invest alone. This meant that the two men started to look for other VCs with the help of the initial VC. As the CEO recalls: "*It took a long time to convince the first VC. After this it was also hard work, but pretty soon we had found four VCs, which finally agreed to invest together*". The company raised 3,6 M€ in the first round of investment in August 2003 (Company website 2005).

The CEO of Company 6 remembers that the team was in a relatively good position in the negotiations for the investments: "*Because we had our service/consulting revenue, which made it easier for us to negotiate, so it was not a question of survival. This was very beneficial. We did not need a couple of hundred thousands urgently…We were all the time ready to 'walk out' so to speak, this was a nice position to have in the negotiations*".

After the company had secured the funding, it quickly started to recruit the necessary technical developers. The headcount soon rose past 10 and then 15. It seemed that the initial idea of helping mobile phone manufacturers to make their software platforms more flexible was a viable one, even if some rival offerings were gaining popularity in the marketplace. During the negotiations with the VCs, the company had organized the cooperation in a way the later have found beneficial. "*We have an advisory board today with 6 persons, with one from each VC. The only real power the investors (the advisory board) have right now is to fire the CEO. Otherwise, they do not have that much direct power according to our agreement….We then have the executive board separately, where there is no investors. This make the governance model quite clear*". During the cooperation, Company 6 has found the cooperation with the VCs very pleasant and constructive. Among the VCs, the company has found difference in involvement, however. "*Some of them are quite active, but I suspect that this is more a question of expertise and personality than of the VC company itself*".

Even though Company 6 had tough negotiations with the VCs, it left no hard feelings on their side. The CEO compares the initial discussions about the terms of the contract as any negotiation, where each party is likely to maximize its own benefit. "*Today the cooperation seems like a partnership more than that of an owner/investor. It is of course so now, as everything is going well. You do not know what is going to happen when things go wrong. But this is also just normal business*".

Today Company 6 employs 20 persons and proceeding well in developing its product.

3.2.7 Case 7

The story of Company 7 begun when an entrepreneur came with one of his new ideas to a business incubator in 1999. During the months after signing the contract with the incubator, the entrepreneur started shaping his idea and looking for financing supported by the incubator team. Soon it became clear that in order to get financing, the entrepreneur had to assemble a team around his idea. As the idea developed further, a specialist with an engineering background joined the team, and committed himself to leaving the incubator if the company would find financing.

The original entrepreneur had a strong entrepreneurial background. He had previously created two companies in the domain of human resources (HR) services. The entrepreneur still saw great potential in the field, and now wanted to utilize his experience in order to create an internet-based solution. The company's solution would span all HR services, with a main focus of handling the payroll functions electronically.

After establishing the initial team, the founders soon came in contact with a VC that was interested in their idea. "*The VC had a special concept. They looked for ideas and person with a very technical focus. Their idea was to insert a marketing and sales manager to the company for a couple of years and then exit, but in our case the solution was slightly different*", recalls the engineer from the incubator that became the company's COO, "*The fund was managing the money of 2-3 very wealthy individuals who had made their money mainly as owners of industrial/consumer goods companies, who had allocated a part of their net worth in to the fund*".

In 2000, after about 6 month from the day the entrepreneur came to the incubator the company had secured financing and was ready for launch. The original entrepreneur would get 90% of the company, while the COO got 5% and two other founders 2,5% each. The fund did not negotiate related to its ownership stake. The funds policy obliged its management to only make investment, where it can get 50% or the company. The only concession the VC made to its policy was that it did not require the team to invest half of the 40 K€ it cost to set up a limited company (which it would have done according to its normal policy).

As the first round of financing closed financing worth 1 M€ for a valuation of 2 M€, the ownership of the entrepreneurial team was reduced to 45%, 2,5% and 1,25% respectively. The fact that team had to give up such a big part of their ownership in the first raised discussion within the team. "*This was a large part of the company to give away, but there really was not room for negotiation because of the funds policy and the fact that we did not have any patentable intellectual property*".

The VC did not tie the payments to any milestones, but instead the money was delivered at a single time soon after signing the contracts. The VC and Company 6 planned to do another investment round after about 12 months.

The company now started to put all its efforts into developing its core product. "*Most of the money was to be used for hiring technical people. We were employing 20 people, of whom 10 people were direct employees and 10 sub contractors from IBM*". The partnership with IBM had been very important for the company already when negotiating for the financing. "*In essence, the idea was that IBM would not develop their HR system online front-end themselves, but rather we would do this, while IBM would concentrate on the back-bone architecture. Our company paid very low fees for the IBM developers. This was a very attractive and strong position for such a small company*".

At first, the development of the solution proceeded well, but after a while, the company faced some technical problems. Although this delayed the launch of pilot versions, they were technically ready in early 2001. Already in December 2000, however, the entrepreneurial team had begun to see problems on the commercial side of the development. According to the COO, the original founder (the CEO) had increasingly isolated himself from the rest of the team and even started to work on two other completely detached start-up projects. This was in violation with the agreement between Company 7 and the VC, and it further meant that sales and marketing activities were not getting due attention.

In late 2000, the VC started to contact the COO directly, although the CEO had been formally in charge of the VC relationship. The reason for this was the COO's earlier relationship with the VC, which he had happily handed over to the CEO when the financing deal was originally made. As the COO started to discuss the problems and the worries of the VC, he began to understand exactly how much time the CEO was using for his other projects. During the next months, the CEO, COO and the VC had meetings to resolve the problem without any major success. It seemed that the CEO was relatively reluctant to change his behavior, but also that the VC did not push hard to resolve the problem.

Within some weeks, it became clear for the COO and the team that the VC had other things on its mind. "*The VC fund was facing a lot of problems in all of its portfolio, and this clearly was reflected also in the relationship between the fund manager and the fund's owners. This was not a positive thing for us, but what was even worse was that the VC fund started to put all its time and energy into another project, which was to revolutionize the computer modem industry. This project failed miserably, the fund lost its credibility and soon the whole fund was in big trouble. As such we began to understand that the fund would not help us further*".

In March 2001, the market in general was loosing its faith in start-ups that based their business on the internet. During this time, Company 7 met with several VCs to find funding. The company also explored different types of other arrangements, but without any promise for further funding or other commercial deals. The VC fund proved to be of little help: "*The VC fund helped us to do this, but only to the extent that they were obliged to do so according to the contract*".

Company 7 tried to find partners or buyers for its business during the following months, but did not succeed in doing so. Finally, in September 2001, the company shut down its operations. The team felt disappointed, and blamed the failure of a combination of bad timing in terms of market collapse, bad management and bad relations with the VC. The COO emphasizes that the relationship with the VC worsened over time: "*In the beginning the relationship with the VC seemed like an alliance, like cooperation with exchange of ideas. Nevertheless, it was not very close cooperation, and we always felt that they could have brought more stuff to the table (contacts, financing etc). Later it just became a conflict, but even then, the VC did not personally seem overly committed*".

3.2.8 Case 8

The founder of Company 8 had been working for a large, international consulting company since 1997. Working in different projects around Europe, the founder started to feel that he would be financially better off doing the consulting for himself instead of for his employer: "*it felt like a nice challenge, but also the internet hype was starting and I was seeing a lot of other people starting their own companies*". The founder –together with some colleagues- left the employer and founded an own company in order to do consulting for their own account. "*We really did not have a business idea at the time; instead we continued to do the same projects as before, but billing the customer directly*". After about a year, a more growth-oriented business idea started to emerge. The founder's brother –who was not part of the consulting business-, had been working on wireless local area networks, a technology that was becoming increasingly popular. The brothers saw a great opportunity in developing this technology and acting as a service provider, and hence Company 8 was founded in august 2000.

"*In the beginning we started to build a service concept, but we soon found that this was perhaps not a valid platform for growth*", says the original founder and CEO of the company, and continues: "*instead we started to focus on providing a platform that would enable other companies to provide the service…this seemed like a more viable business model, but one which required financing*". The company started to work on a technical proof of concept and simultaneously looking for financing. In early 2001, the company contacted tens of potential financers, got meetings with "*about twenty*" and negotiated with a handful of VC companies. "*Looking back at it, I feel that we were perhaps a bit naïve in thinking that it would be quite easy to get financing, this was of course not the case*". As the company was realizing the challenges in finding financing, it came across the representatives of the VC company 3i, who had already invested in a small company working with a similar technology. The other company had a strong technological backbone, while Company 8 had good access to customers and an international presence, although its technology was not yet fully developed. The other company had run into problems, and had been forced to fire a large part of its employees to cope with the situation. The complementarity was obvious to the VC as it was to the two companies. As such, the VC offered to finance the two companies if they merged. After further negotiations the agreement was finally reached, and the new company (which took on the name of Company 8) received 1,5 M€ of financing in early 2002.

The CEO of Company 8 recalls that the valuation –management kept a majority in the company- of the first round was not at all bad given the market situation and the fact that the VC already had a stake in the other company. "*The founder of the other company had a long business background and was quite skilled in dealing with VCs. We on the other hand had already established quite nice operations. Both of these facts combined gave us a good negotiating position*".

The money raised was used to further develop the product and hire two new sales representatives. The new company was able to establish itself as a viable player in the market and soon found customers all over the world.

In 2002-2003, although the business of Company 8 was progressing quite well, the company started to see that its original growth targets were hard to meet. The reason for this was that the estimates made during the hype were overly optimistic. Although the technology remained viable and of growing importance, the business did not grow as planned. In 2004, the management of Company 8 and the VC started to see that the interests of the two companies were not fully aligned. As the growth of the business was not as fast as planned, Company 8 did not meet the goals of the VC and wanted to explore the option of backing out of the investment. "*Even though this was made clear to us, we did not feel pressured or forced in any way…the VC has always had a very neutral and objective approach to us*", recalls the CEO and says that the positive relationships is probably a result of the fact that the VC is so big and experienced. He also credits this to the persons involved, however: "*our contact person was very professional and understood our business…he also allowed us to make decisions and did not get involved in details*". After some months of negotiations, the two companies decided to end their formal cooperation, as the management of Company 8 bought out the VC.

In 2005, the company has kept the same focus in business, still has good relations with the VC and is benefiting from a market that remains growing.

3.2.9 Summary

In summary, it can be said that the cases display great variance in how they describe the relationship between VCs and entrepreneurs. While agency problems are even admitted by some of the entrepreneurs themselves, a picture of a different kind of cooperative relationship is also emerging. The next section aims at finding the characteristics of such behavior by doing cross case analysis, followed by some propositions for further studies to explore and a model for better understanding the relationship between VCs and entrepreneurs.

3.3 Findings

3.3.1 Propositions

Because of their varying nature, the cases display many aspects of the VC-entrepreneur relationship. The findings presented next are the result of a cross-case analysis, in which each case has been exploratively compared (Miles and Hubermann 1994) to the theoretical foundation laid in the beginning of the article. The matrix in Table 1 is presented first, followed by a number of propositions. Each proposition is supported by links back to the case information.

<INSERTION 1: Table 1 – Cross case explorative matrix (Summary of case data)>

The findings suggest that two different types of propositions can be formulated.

First, as the cased data presented earlier and Table 1 clearly shows, the rate of success or problems seems to impact the relationship between VCs and entrepreneurs. Here also the initial characteristics of the entrepreneurial team seems to be of importance. The first three propositions, presented next, try to clarify these issues and are commonly called *fundamental* propositions. The fundamental propositions –although in themselves contributive- are above all presented to provide to a basis for further theory development.

The second type of propositions identified are here called *explicative* propositions. These three propositions continue to refine the basic picture displayed by the fundamental propositions. The explicative propositions aim at highlighting the more complex dimensions of relationships, many of which have to do with alliance-related notions such as trust and learning.

Proposition 1: Successful entrepreneurial companies are more likely to experience positive relationships with VCs

The first fundamental proposition concerns the positive attitudes expressed in successful cases. The cases –hardly surprising- suggest that successful entrepreneurs are more likely to experience the relationships with their VCs as fair and "*alliance-like*". The purest example of this is case 1, where the entrepreneurs had had virtually no problems with the VC. In fact, the opposite was true, as the VC had used much more time to help the company, than the entrepreneurs had originally even hoped for. In addition, company 6 seems to back this suggestion, as the company's business has been advancing according to plans, and the VC relationship was described as an alliance between equal parties.

Proposition 2: Entrepreneurial companies with a strong position related to team, idea, timing and operations are more likely to experience positive relationships with VCs.

As previous literature has noted, the success of the new venture often depends on certain key factors. This study suggests that this is equally true with the perceived success of the cooperation with VCs. The argument here is twofold. First, the team and idea are especially important in convincing the VC early in the dialogue. The team and the idea lay the base for the negotiations and the balance in the relationship. As this base has been achieved, the negotiations move on and two other factors gain importance. Timing of the negotiations is a critical factor, as many of the cases of this study show (the dot.com hype showed both extremes of this aspect). What is perhaps less highlighted is the level of operations within the start-up company. For example, cases 1 and 6 highlighted the importance of having ongoing operations as a basis for the relationship with the VC. In case 1, the company had already started its operations, the founders had resigned from their previous jobs and had hired employees before they started to negotiate with the VCs. This clearly convinced the VC, and also put the company in strong position to start with. On the other hand, in case 6, the company had a steady cash-flow, which enabled the entrepreneurs to negotiate on more equal terms, which laid a beneficial base for the cooperation.
The fact that some companies had a beneficial team, idea, timing and operations seemed to contribute to a positive, alliance-like relationship. The proposition made here is that this was due to getting a fair deal from the beginning and a more central position in the portfolio of the VCs.

Proposition 3: Unsuccessful entrepreneurial companies are less likely to experience positive relationships with VCs

In addition to the successful cases, also the unsuccessful cases seem to suggest a congruent approach for explaining the relationship with the VCs. This can be observed in Company 7. Here, it seemed the cooperation between the VC and the CEO very soon became flawed, as the CEO was not committed to agreements with the VC, and later as the VC focused more on other companies in its portfolio. Also in this case, the entrepreneurs did not see the cooperation as much more than a financial investment. This became increasingly clear towards the end of the cooperation, when Company 7 faced serious problems. In the later parts of Case 3, the entrepreneurs found themselves facing problems with their VC, when other problems began to arise. As the goals of the VC and the company became unaligned (Company 3 would have liked to grow more cautiously while the VC wanted to see a rapid international expansion), the relationship worsened rapidly. In this case, the cooperation was soon only about the obligation in the written contract and as such the entrepreneurs experiences the entire cooperation more as an "*investment*" than "*any form of win-win cooperation*" (CFO, Company 3).

The suggestion that successful entrepreneurs have alliances with VCs and unsuccessful entrepreneurs have pure investments guarded by contracts is a dichotomy aligned with the extant theory presented earlier in this article. What introduces new questions is, however, how positive, value-adding relationships can be found also in cases with unsuccessful entrepreneurial companies.

Proposition 4: Even successful entrepreneurial companies, with a strong starting point can experience the relationship with VCs as negative if certain conditions are met.

The first explicative proposition refines the basic tenets suggested above. In case 3, the entrepreneurial team was ready to admit that it did not have experience or knowledge about dealing with VC companies. As the company was seeking VC money partly to grow, but also "*because this was a thing for every self respecting company to do*", it did not fully understand the drivers of the VC. As such, it could be argued that the company was always successful. During its first years of existence, it held a central position in the market and was doing profitable business. Even though it could rightly be argued that the company was successful (in the beginning), it soon began to face problems with its VC. The goals of the company were unaligned, as the entrepreneurial team wanted to build a solid business, and the VC wanted aggressive growth and high risk.
The answer to the problems of Company 3 could have been to gain a better understanding of the VC company and the characteristics of the VC industry in general. Nevertheless, this understanding could also have been beneficial to create later in the relationship. As the CFO of Company 5 puts it "*you have to understand what the VCs are after, often it seems like the opposite to your needs, but in fact it is your job to manage their requests, and defend your own decisions*". It is suggested that the lack of this type of understanding, which leads to better knowing the other party's business and incentives, can make even successful entrepreneurial companies experience grave difficulties in their VC relationships.

Proposition 5: Even unsuccessful entrepreneurial companies that understand the VC industry and the goals of the specific VCs can experience positive relationships with VCs if certain conditions are met.

The data of this study suggests that even unsuccessful companies can have experiences positive relationships with VC, which they feel could be called "*alliances*" or "*win-win cooperation*". In Case 2, the entrepreneurs willingly abandoned the strategy of organic, portfolio-based growth and decided to take the high-risk road of focusing on a single product, aimed at a global market. According to the entrepreneurs they understood the risks and they had a feeling a mutual understanding with the VC right from the beginning. Even as the company went bankrupt, the entrepreneurs felt that the VC had supported them optimally right to the end. It seems that because the management was willing to take on a project with a very high-risk profile, the goals of the VC and the company was aligned until the very end, and as such, the relationship was perceived as positive until the very end.

3.3.2 Towards a congruent view

The five propositions above (sixth proposition: see below) highlight the different aspects of the relationship between VCs and entrepreneurs. Based on the cases it is clear that the relationship cannot be explained purely by displaying agency problems. Instead, also the aspect of equal and fair "*alliance-like*" cooperation is found in the cases. While this dichotomy of success creating positive stories and failure creating negative stories is present, it is notable that the reality is even more complex than that.

To depict an inclusive, congruent view of "*both sides of the coin"* in the VC-entrepreneur relationship, this article suggest a model, presented in Figure 1. The starting point of the model – the timeline- was derived from the case data. The case data seemed to suggest that there are three distinct, chronological phases that each contribute to the perceived nature of the cooperation. The first stage that seems to be of importance is the *pre-dialogue* state of the entrepreneurial company. As the company starts negotitations with one or several VCs, the process moves into the *pre-investment* phase. After the investment decision is done, the relationship moves on into the third stage, *cooperation*[5].

Framed by the chronological stages, the model aims at capturing the essence of the findings and six propositions of this article. It suggests that base for the relationship with the VC is created in four aspects (team, idea, timing, operations) even before the cooperation or discussion of cooperation with any VC has begun. These four aspects then influence –but do not, however, determine- the inclination of the relationship.

The four initial aspects greatly influence the understanding the entrepreneurial team has of the VCs they are negotiating with and the VC industry in general. Here, especially the team and its experience and the existing operations (e.g. access to experts, lawyers etc) have great impact on how much information the entrepreneurs have of the nature of VCs. In the interviews all entrepreneurs that did

[5] It could here be argued that there is further stage of the model, namely *dissolution*. This stage is in the model implicitly represented by the retrospective stage of perception.

not have such extensive knowledge, stated that they would have benefited from it greatly, and the ones that had agreed that it was very useful.

<INSERTION 2: Figure 1 – Key aspects in the development of VC-Entrepreneurship relationships (Inclusive model with propositions)>

The decision to get VC financing seems to have a great impact on the general strategy of the entrepreneurial companies. As for example in Case 5, where the CFO of the company had a long experience in working with VC, the company understood that it needed to pursue a strategy of fast growth to satisfy the expectations of the VCs. As such, the company followed a path of growth and risk taking (see "*managed risk taking*" in the model, which refers to the fact that an entrepreneur needs to make their own decisions and keep control of the company, even if they also have to meet the needs of the VCs) which led to the VC-cooperation being described as alliance like, and neutral. Another example of a company that seemed to understand the implications of taking on VC money was company 2, that followed a similar path (the path in the bottom of the model), and as such experienced a positive relationship regardless of the poor performance and failure of the venture.

The upper side of the model refers to a situation where the entrepreneurial company has poor understanding of the VC business. Even in this case, it is possible for the cooperation to be perceived as positive and alliance-like. The risk –especially if the venture is successful, e.g. generating a positive cash flow- is that the entrepreneurial team experience the well documented problem of escalating commitment (Staw 1976), which leads to risk averseness as the team does not want to risk what has been built earlier (this relates back to Proposition 4). It is further suggested that escalating commitment can also be produced in entrepreneurial companies with poor performance, and a management that responds to this by minimizing risks. In either case, the team's goals become increasingly unaligned with the goals of the VC, and conflict arises, as could be seen in e.g. Case 3.

Besides an understanding of the other party's business and incentives (Seppälä 2004), learning has been highlighted as a key aspect of alliances (Doz 1996). The findings in this study suggest that learning is also a central notion in successful cooperation between entrepreneurs and VCs. It is especially in the situations where the entrepreneurs do not have a good understanding of the VC industry, where an evolution in the relationship can be particularly beneficial. This aspect constitutes the sixth and last proposition:

Proposition 6: Learning and evolution are vital elements in the VC-entrepreneur relationship, especially in cases, where the entrepreneur does not have full understanding of the VCs business.

Here, a successful entrepreneur[6] can learn about the VC's expectations related to growth and learn to manage the relationship, the company and communications to the VC accordingly. It is however, worth noticing that this is of course not the only aspect in which learning and evolution occurs in the VC-entrepreneur relationship. Instead, many of the entrepreneurs who had experienced a positive relationship with the VC, and used the word "*alliance*" to describe it, reported that formal contracts never guided their cooperation, but rather that there was an on-going dialogue which facilitated a constant evolution. With this evolution, the perhaps initially inexperienced entrepreneur should learn to take charge in critical situations, as the CFO of Company 5 explains: '"*We need VCs and they are doing a very important job, but you have to be tough, this is your company and not theirs. They help you, but you must decide. Also their vision becomes more and more superficial compared to yours over time*". The aspect of taking control while managing the VCs expectations is represented by the field "*managed risk taking*" in the model.

In summary, it can be said that the findings of this article suggest that there is indeed a wealth of elements in the relationship between entrepreneurs and VCs which do not fit into the agency theory guided paradigm. The significance and contributions of these findings are discussed next.

[6] Also the VC can and should learn in the relationship. It is however suggested, that as the market of VC financing is seldom efficient, and the entrepreneur is usually much more dependent on its financier(s) than vice versa, the incentive to learn to manage the relationship is stronger with the entrepreneur.

3.4 Conclusion and recommendations

This article has presented some new views on the relationship between entrepreneurs and VCs. The research path followed has explored the almost ignored view that there can be learning and fairness (Busenitz et al. 2004) in the relationship, much like described in general alliance literature. This study has also put the entrepreneur in the focus of the research, where previous studies have predominantly focused on the VC as the focal company (Arthurs and Busenitz 2003). As such, the findings of this study should be seen as an early attempt to qualitatively build an understanding of the nature and key characteristics of the non-agency-problem side of the VC-entrepreneur relationship.

3.4.1 Theoretical contribution

The data used in this study suggests that the relationship between VCs and entrepreneurs can meet the commonly accepted definitions of being an alliance (maximizing value of both parties, fairness, learning). As such, the study contributes to an emerging theoretical body of knowledge around the relationship between VCs and entrepreneurs (Busenitz et al. 2004). The article further extends the discussion of resource-based theory into the field of entrepreneurship, as advocated by Alvarez and Busenitz (2001).

The article goes further to study how entrepreneurs perceive different sorts of cooperation with VCs, and what the key characteristics are that determine whether the cooperation is guided by agency-problems or value maximization, learning and fairness. Here, the study proposes a model and highlights six propositions, which are key triggers for determining the practical crossroads of the two theoretical avenues. The findings presented in this article hence directly forward the approach of Arthurs and Busenitz (2003), who present three key gaps in current theory. Especially the effect on goal congruence and trust in the relationship and psychological ownership (Ibid, p. 159) of the entrepreneur is better understood through the findings presented in this article.

3.4.2 Practical contributions

This article strongly takes the entrepreneur's view in looking at the VC-entrepreneur relationship. As such, many of the practical contributions may be more relevant to an entrepreneur audience. Nevertheless, as VCs are seeking to invest in the best entrepreneurial companies and to maximize the performance of their own portfolio, it could also be in their interest to explore this "*other*" side of the relationship.

This article suggests that entrepreneurs should start preparing for the VC relationship even before they begin to negotiate about financing. Here the team, idea, timing and operations considerably affect the nature of the negotiations and the future cooperation. The entrepreneurial team should further critically examine its understanding of the VC business, and the goals and business of a particular VC before committing to anything.

While the initial conditions of the relationship affect its nature further on, this article suggests that learning is inevitable in the relationships. Here, the entrepreneur should learn to understand the changes in the relationship, understand the needs of the VC and learn to manage and align the need of both companies in the new situations.

3.4.3 Suggestions for further research

This article has presented several new aspect of the relationship between VCs and entrepreneurs. Even so, this stream of research is still emerging, which means that "*a solid theoretical foundation for the VC-[entrepreneur] relationship has yet to be laid*" (Arthurs and Busenitz 2003, p. 159). Hence, this article suggests that more in-depth case studies of various nature are needed to surface as many aspects as possible of the relationship. Especially interesting seems to be the learning aspect, where entrepreneurs –who often are less experienced in the beginning of the relationship- learn to manage the expectations and needs of the VCs to take control, (re-)align the goals and create an atmosphere of joint value maximization.

4. Biography

Dr. Martin Seppälä holds a M.Sc. (Econ.) degree from Åbo Akademi University and a Ph.D. (Econ.) degree from Hanken, Swedish School of Economics and Business Administration. Dr. Seppälä has been a strategy consultant for six years, working internationally with such companies as Accenture , Nokia and HP on issues related to strategy, business growth and cooperation. His academic work includes papers and articles on topics such as strategy, alliances, the ICT industry, entrepreneurship and venture capital. Dr. Seppälä is a post-doc researcher at Hanken (Helsinki, Finland) and during 2005 working as a visiting professor at CERAM Sophia Antipolis in the Sophia Antipolis technology park in France.

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Case:	1	2	3	4	5	6	7	8
Industry:	ICT/ Biotech	Mobile Enablers	Mobile enablers	Mobile/ Finance	Biotech	Mobile enablers	ICT/ HR	ICT
Company founded:	2000	1996	1998	1995	1996	2002	1999	2000
1st round (or seed if applicable)	8/2000	2001	1999	1998	1996	8/2003	1999	8/2000
Total amount of rounds (incl. seed, bridge and IPO)	4	1	6	2	5	1	1	1
Amount of money raised	>10 M€	N/A	~4 M€	N/A	126,8 M€ (8,3 M€ pre-IPO)	3,6 M€	1 M€	1,5 M€
Type of VC(s)	Private VCs	Private VCs	Private VCs	Corporate VC	Private VCs	Private VCs	Private Fund	Private VC
IPO	-	-	-	12/1999	11/1999	-	-	-
Current state (Q1/2005)	Growing	Bankrupt 10/2001	New growth after difficulties	IPO, divested, partly bankrupt	IPO, growing	Growing	Bankrupt 9/2001	Growth, MBO 2004
VC relation-ships described as:	"Alliance" "Coope-ration"	"Alliance" "Coope-ration"	"Invest-ment" "Tough play"	"Invest-ment" "Big influence"	"Neutral" "Invest-ment/ alliance"	"Neutral" "Invest-ment/ alliance"	"Invest-ment/ prob-lematic"	"Positive" "Coope-ration"

Table 1: "Cross-case explorative matrix"

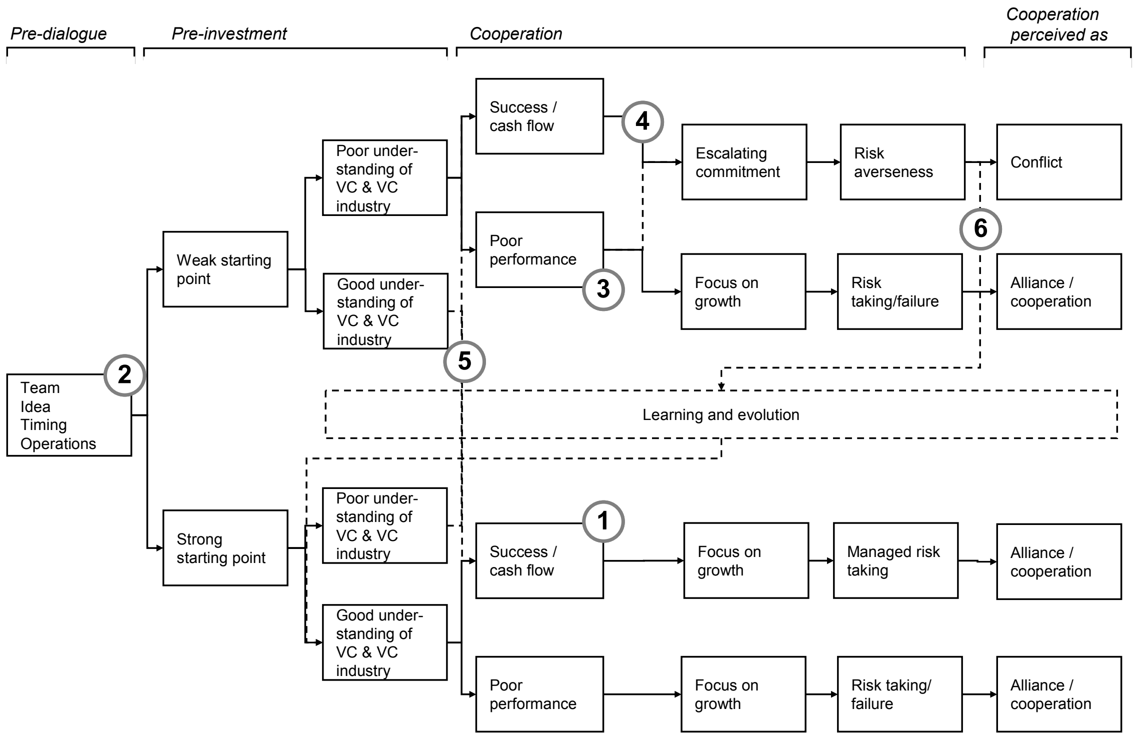

Figure 1: – Key aspects in the development of VC-Entrepreneurship relationships