

**CONFLICTS BETWEEN VENTURE CAPITALISTS AND CEOs OF THEIR
PORTFOLIO COMPANIES**

Dmitry Khanin

Texas Tech University
dmitry.khanin@ttu.edu

Ofir Turel

California State University – Fullerton
oturel@fullerton.edu

ABSTRACT

Prior research has established that venture capitalists (VCs) and CEOs of their portfolio companies often disagree on venture policies. Such disagreements can escalate into cognitive conflicts. Relationship-based, or affective, conflict may also arise between VCs and CEOs. This paper examines the antecedents and dynamics of such VC-CEO conflicts and their effects on CEOs' expectations as to what financial intermediaries they would like to choose for their new ventures. Based on a survey of 104 CEOs of VC-backed ventures, we establish that, following conflict with VCs, CEOs may elect to avoid using any financial intermediaries, or to choose business angels or corporations as financial intermediaries. Alternatively, CEOs may decide that they still want to work with VCs in the future and strive to ameliorate their collaboration with VCs.

Keywords: venture capital, conflict, CEOs, financial intermediaries

INTRODUCTION

Conflicts are defined in the literature as perceived incompatibilities between the parties (Boulding, 1963; Jehn, 1995).

Researchers have emphasized the multidimensional nature of conflict

(Pinkley, 1990; Jehn, 1995). The intergroup conflict theory divides conflicts into cognitive, or task conflicts (conflicts about real issues and alternatives), and affective, or relationship conflicts (highly emotional conflicts frequently prompted by the perceived personal frictions) (Priem & Price, 1991; Mooney et al., 2007).

Cognitive conflicts have long been described in the literature as functional because creative discussions allow to clear the air, help to overcome the tendency for groupthink, spur innovation, and consequently, improve organizational performance. As an example, entrepreneurs may differ in their expectations for growth, and the importance of such activities as formal business planning, perceptions of environmental uncertainty, and risk preferences (Matthew et al., 2009). The same could be true of VCs and entrepreneurs. For instance, VCs may be likely to emphasize the advantages of planning and exhibit greater risk aversion and tolerance for uncertainty and ambiguity than entrepreneurs. In contrast, affective conflicts have long been considered as dysfunctional due to their adverse effect on team cohesion and collaboration (Amason, 1996; Ensley et al, 2002). Recently, though, researchers have offered a more pessimistic view of cognitive conflicts as leading to a number of negative consequences, especially because they often underlie affective conflicts (De Dreu & Weingart, 2003; Mooney, Holahan, & Amason, 2007).

Both cognitive and affective conflicts may arise in the process of collaboration between venture capitalists (VCs) and CEOs of their portfolio companies (Higashide & Birley, 2002; Yitshaki, 2008; Forbes, Korsgaard, & Sapienza, 2010). Researchers pointed out several pitfalls in the VC-entrepreneur relationship that may result in such conflicts. First, scholars established that insufficient, or inadequate, VC assistance may cause CEO dissatisfaction with VC support and lead to VC-CEO conflicts (Gorman and Sahlman, 1989; Sapienza, 1989; Ehrlich et al., 1994; Barney et al., 1996; Higashide and Birley, 2002; Berg-Utby, Sorheim, Widding., 2007). Furthermore, research has provided

evidence that VCs may pay even less attention to the venture when they are focused on quickly expanding their portfolio. As a result, VCs may end up financing too many ventures and thus diluting their resources (Shepherd, Armstrong, and Levesque, 2005; Jääskeläinen, Maula, Seppä, 2006). Second, studies showed that VC-CEO conflicts may arise as a result of the exorbitant cost of VC financing compared to that of other financial intermediaries (Hsu, 2005; Florin, 2003; 2005). This may lead to conflicts of interests between VCs and CEOs. Such conflicts may arise when VCs and CEOs disagree on venture valuations, particularly during the down rounds of investment when VCs' equity stake often skyrockets, whereas CEOs' share plunges (Forbes, Sapienza, & Korsgaard, 2010). On these grounds, researchers recommended entrepreneurs to choose carefully their financial intermediaries among VCs, banks, business angels and corporations or corporate venture capitalists (CVCs) (Ehrlich et al., 1994; Ueda, 2004; De Bettignies and Brander, 2007).

In this paper, we address the question that has not been examined in prior research on VC-CEO conflict: what lessons do venture CEOs draw from their conflicts with VCs? Could they decide not to use any financial intermediaries? Could they make the resolution to avoid VCs in the future, but seek other financial intermediaries, such as corporations and private investors? Could they become critical of their VCs' performance, but hope that other VCs would do a better job? Or could they blame themselves, and their own inability to avoid conflict escalation? To answer these questions, we conducted a survey of CEOs whose ventures had received VC financing in the 2000s (before January, 2009). Survey was complemented by interviews

with CEOs. In addition to answering the questions on the survey, the respondents provided useful comments that helped us better understand the causes and dynamics of VC-CEO conflicts. Luckily, several CEOs also volunteered to talk to us and provided some background information.

The main contribution of this study is showing that VC-CEO conflicts may have a strong impact on CEOs' intentions as to whether or not to recruit financial intermediaries for their new ventures; what intermediaries to use or not to use; and how to better adjust their own behavior in the future to accommodate VCs' requests and thus avoid conflict escalation causing harm to the venture. The paper is organized as follows. In the first section, we discuss the key causes of VC-CEO conflicts uncovered in the preceding literature on the subject. In the second section, we unveil our theoretical model of the antecedents and dynamics of VC-CEO conflicts and CEOs' intentions with regard to using financial intermediaries in the future. In the third section, we describe our methods and sample. In the fourth section, we report and discuss the results. In the fifth section, we present the conclusions. Finally, in the sixth section, we point out the study's limitations and its practical implications for VCs and CEOs, and outline directions for future research.

LITERATURE REVIEW: REASONS FOR CONFLICTS AND DISAGREEMENTS BETWEEN VCS AND ENTREPRENEURS

Prior research has uncovered the three main areas of VC-CEO conflicts. The first area can be described as "conflicts of interests and unfavorable attributions." Conflicts of interest address zero-sum game situations when what benefits VCs could hurt CEOs,

and vice versa. For instance, the higher venture's pre-money valuation, i.e., what it is worth before VC capital infusions, the better for venture CEOs and the worse for VCs. Naturally, VCs and CEOs fiercely argue about pre-money valuations and may never reach a consensus. Negative attributions refer to biased opinions that parties hold with regard to one another. Thus, CEOs may view all VCs as short-term oriented and controlling, whereas VCs may view all CEOs as excessively committed to the venture and not able to soberly define its merits and shortcomings, avoiding unnecessary emotions.

Importantly, it is difficult for CEOs to voice their actual feelings toward VC support or lack thereof because VCs wield significant power in the relationship (Sahlman, 1990; Wasserman, 2007). As a result, VCs may not really know what CEOs think (although some VCs may not be particularly concerned about CEOs' actual feelings anyway, assuming that a certain degree of hostility is unavoidable). Due to information asymmetry and imperfect, cluttered lines of communication between VCs and CEOs, VCs may act in good faith and overemphasize some areas of assistance that CEOs consider to be less useful while providing insufficient support in other areas that CEOs may view as absolutely critical (Rosenstein et al., 1993; Ehrlich et al., 1994; Barney et al., 1996). Furthermore, VC support may be insufficient or inadequate, due to their multi-tasking, the small size of most VC firms, their cumbersome hierarchical structure, increasing portfolio size, hiring of inexperienced recruits lacking operational experience, etc. (Gifford, 1997; Keuschnigg and Nielsen, 2004; Cumming and Johan, 2007). In addition, parties' mutual perception as incompetent may be

strengthened and reinforced due to rampant negative attributions.

Agency conflicts between VCs and CEOs (Sahlman, 1990; Shane & Cable, 1997; 2001; Gompers & Lerner, 2004) arise due to the potential for opportunistic behavior on both sides (Cumming and Johan, 2007). Therefore, agency conflicts also belong in this first category of conflicts of interests and negative attributions. Finally, VC-CEO conflict may arise due to the greater attention apportioned by VCs to other ventures in the portfolio. For example, CEOs may believe that VCs spend too much time helping their least successful and underperforming, or even failing companies, (Timmons & Bygrave, 1986; Fredriksen et al., 1990; 1997; Elango et al., 1995) and focus on putting out fires (Fredriksen et al., 1990; 1997) while neglecting viable ventures.

The second area of VC-CEO conflicts is “conflicts of inefficient collaboration.” For instance, VCs’ oversight may be too intrusive, in CEOs’ opinion, – “they want to keep us on a short leash” (Gomez-Mejia et al., 1990; Jog et al., 1991). In turn, VCs commonly believe that CEOs fail to communicate relevant information to them in a timely manner or even withhold critical information on purpose (Sapienza & Korsgaard, 1996). Therefore, not only agency conflicts, but also collaboration problems (Shane & Cable, 1997), could explain the reasons why VCs and CEOs are in conflict. Low goal congruence between VCs and CEOs observed in prior research (Sapienza & Gupta, 1994) certainly has to do, not only with the discrepancy between these allies’ vested interests and appropriation concerns (Gulati, 2007) and fear of opportunism (Sahlman, 1990; Cable & Shane, 2001), but quite simply with

ineffective communication and collaboration.

These multiple reasons for VC-CEO conflict uncovered in previous studies allow deepening our understanding of the types of conflicts that may occur in the VC-CEO relationship. For instance, VC-CEO cognitive disagreements regarding their goals and policy may not only arise as a result of having different views on tasks and processes, but also because of different vested interests and agency problems. In turn, affective conflicts between VCs and CEOs may crop up not merely because of personal frictions and relationship problems but also due to ineffective collaboration. Finally, cognitive and affective conflicts may be closely related: what starts as a cognitive conflict may grow to become an affective conflict (Higashide & Birley, 2002) and what begins as an affective conflict, may spur cognitive conflict (Yitshaki, 2008). For instance, cognitive conflicts may turn into affective conflicts because of the way the parties treat one another (ineffective communication and collaboration). VCs may not properly communicate to CEOs the importance of generating adequate performance reports and making their management objectives transparent. As a result, CEOs could view such activities as redundant and useless (Ehrlich et al., 1994). VCs may also abuse their power, encroach upon CEOs’ territory (MacMillan et al., 1986) and be trigger-happy – ready to dismiss CEOs on the spur of the moment (Willard et al., 1992; Flamholtz, 1994; Wasserman, 2007).

Both VCs’ rigid control and excessive interference into venture governance and CEOs’ noncompliance, insufficient feedback and paranoia with regard to imminent VC takeover could instigate VC-CEO conflicts in the area of inefficient

collaboration. CEOs may feel that the transaction and coordination costs of operating under VC tutelage are too high, fear that VCs will replace them as soon as they develop sellable products (Wasserman, 2003, 2006), express apprehension that VCs would usurp their decision making authority (Steier & Greenwood, 1995; Botelho & Jonathan, 2006), resent VCs for keeping them on a tight leash and seizing venture governance (MacMillan et al., 1988), and object to VCs' aggressive voice in response to unmet expectations (Parkahangas & Landstrom, 2006).

The third group of conflicts can be defined as "conflicts of VC-CEO mismatch." Perry (1988) described the main types of entrepreneurs as a) inventors (interested in developing a specific product and reaping the financial rewards while leaving venture management to others); b) builders (preoccupied with creating a viable enterprise); and c) innovators (absorbed in developing an advanced technology rather than a specific business). Respectively, Perry (1988) categorized the main types of VCs as a) investors (focused on achieving fast financial results); b) advisors (top-tier VCs that may offer valuable counsel and advice if provided sufficient feedback); and

c) partners (VCs with deep pockets willing to support an extensive search for advanced technology). Perry (1988) hypothesized that conflicts between VCs and CEOs may arise if such partner types are mismatched. Thus, while the combinations of inventors-investors, builders-advisors and innovators-partners, according to Perry (1988), are ideal, an alliance between a builder and investor could lead to a conflict. Other researchers have argued that since the costs of VC financing are very high (Hsu, 2005; Florin, 2006), CEOs may find a better match with other types of financial intermediaries, such as business angels (Ehrlich et al., 1994), corporations (Jääskeläinen et al., 2006) and banks (Ueda, 2004). In addition, studies have shown that venture CEOs may have different needs in terms of the required amount of operational vs. strategic assistance (Barney et al., 1996; Ehrlich et al., 1994). Therefore, some CEOs could be better off with specialist VCs focusing on operational experience, whereas others could need generalist VCs. Table 1 sums up our discussion of the causes of VC-CEO conflicts in previous research.

Table 1: The Principal Causes of VC-CEO Conflicts Identified in the Literature

#	Causes of Conflict	Studies
I.	Conflicts of interest and negative attributions:	
1.	VC support falls far short of CEOs' expectations	Rosenstein et al., 1989; 1990; 1993; Flynn, 1991; 1995; Berg-Utby et al., 2007
2.	VCs' limited attention and their decreasing support for individual ventures as a result of portfolio growth leads to CEOs' dissatisfaction with the quality of provided advice.	Gifford, 1997; Shepherd et al., 2005; Jääskeläinen et al., 2006; Cumming & Johan, 2007

3.	VCs and CEOs disagree as to the areas in that VC support should be increased or decreased	McMillan et al., 1986; Ehrlich et al., 1994; Barney et al., 1996
4.	Parties disagree based on their vested interests on pace of growth, timing and modes of exit	Jog et al., 1991; Ehrlich et al., 1994; Wright & Robbie, 1998
5.	Agency conflicts: CEOs' incompetence, shirking, opportunistic actions, hold-up threats, moral hazard, overspending	Sahlman, 1990; Jog et al., 1991; Shane & Cable, 1997; 2001; Hellmann & Puri, 2002; Kaplan & Stromberg, 2004; Gompers & Lerner, 2004; Parkahangas & Landstrom, 2006
6.	VCs spend too much time supporting troubled ventures, and thus, do not have enough time for more viable companies	Timmons & Bygrave, 1986; Fredriksen et al., 1990; 1997; Elango et al., 1995
7.	CEOs view VCs as incompetent, especially in the areas of venture management and operations, and contributing to venture failure	Gomez-Mejia et al. (1990); Gabrielsson & Huse, 2001
8.	VCs view CEOs as an annoyance and even as a selfish and destructive force	Gorman and Sahlman, 1989; Willard et al, 1992
9.	VCs and CEOs make different attributions	Zacharakis et al., 1999
II.	Conflicts of inefficient collaboration:	
1.	Low goal congruence between VCs and CEOs	Sapienza, 1989; Sapienza & Timmons, 1989; Sapienza & Gupta, 1994;
2.	VC support could be counterproductive due to its rigid nature, and hence, adverse effect on innovation	Gomez-Mejia et al., 1990; Barney et al., 1996; Higashide & Burley, 2002; Wijbenga et al., 2007
3.	Cognitive disagreements (about goals and policy) and personal or affective frictions	Higashide & Burley, 2002
4.	CEOs object to the time spent in generating performance reports and fulfilling other VC requirements	Ehrlich et al., 1994; Jog et al., 1990
5.	CEOs criticize VCs for masterminding and monopolizing some of their activities and acting dictatorially	MacMillan et al., 1986;
6.	VCs believe that founder-CEOs should rather be replaced	Willard et al., 1992; Hellmann & Puri, 2002; Kaplan & Stromberg, 2004; Wasserman, 2007;
7.	CEOs fear loss of flexibility and decision-making authority	Barney et al., 1996; Botelho & Jonathan, 2006
8.	CEOs bemoan the increased transaction and coordination costs	Steier & Greenwood, 1995; Botelho & Jonathan, 2006
9.	CEOs object to VCs' inconsiderate and aggressive behavior	Sapienza, 1989; Parkahangas & Landstrom, 2006;

III.	Conflicts due to VC-CEO mismatch:	
1.	VCs and CEOs choose the wrong type of partner	Perry, 1988
2.	CEOs would be better off with private investors	Freear & Wetzel, 1990; Ehrlich et al., 1994; Osnabrugge, 1998
3.	CEOs would be better off with more experienced VCs	Sweeting, 1991; Sapienza et al., 1994; Smith, 2001
4.	CEOs would be better off with more (less) operations-focused VCs	Ehrlich et al., 1994; Barney et al., 1996
5.	CEOs could be better off with corporate investors	Maula et al., 2005
6.	CEOs could be better off with borrowing from banks	Florin, 2000; Hsu, 2005

THEORY DEVELOPMENT

The Antecedents of Cognitive Conflicts between VCs and CEOs

Prior research has examined the distribution of attention inside the VC firm (Gifford, 1997) and the impact of VCs' increasing portfolio on the amount of attention allocated to individual ventures (Kanniainen, Keuschnigg, 2003; 2004). In addition, we suggest taking a closer look at the other side of the coin – the distribution of attention inside the entrepreneurial venture. The attention-based view of the firm (Ocasio, 1997; De Clercq, Castaner, Belausteguigoita, 2006) suggests that organizations selectively approach issues as important or less important. These preferences are situated in the organization's procedural and communication channels and may be reified through cultural symbols, routines and interactions among organizational members. Moreover, attention is structurally distributed throughout an organization so that organizational members are responsible for performing specific functions and roles integrated into clusters of activities (De Clercq et al., 2007).

When VCs take over, they may actively

interfere with the existing distribution of attention in the entrepreneurial venture by introducing new sets of priorities. VCs typically request that a company changes its temporal orientation by focusing on short-term reporting periods geared toward the accomplishment of certain preset goals defined as milestones (Jog et al., 1991; Gompers & Lerner, 2004). This change in the firm's temporal orientation and respective reporting procedures clearly represents a departure from prior organizational rhythms emphasizing exploration, that is, search for new knowledge. Exploration and exploitation are different activities that companies find difficult to combine, and hence prefer to switch between the two modes (Siggelkow & Rivkin, 2006). VCs seek to reorient a venture from exploration to exploitation by isolating an area of activity that is most likely to be successfully commercialized, and directs CEO's attention to such promising area to the exclusion of others. This could lead to a sea change in a venture's strategy. While founders often endorse a broader strategy of exploration, VCs insist on narrowing a venture's focus and pursuing a strategy of exploitation to expedite the launch of a promising product. Concomitantly, VCs insist on greater

accountability and coordination. These changes could be momentous and require some adjustment and fine-tuning.

Although VCs may desire to redirect the process of distribution of attention inside a venture by changing its temporal orientation, focus, strategy and patterns of coordination, they may not, in fact, have enough time, or even sufficient knowledge and expertise, to assist a venture in implementing such far-reaching transformations. As a result, CEOs may feel that they have not been provided enough guidance, and begin to doubt VCs' competence as agents of change (since the latter may not possess the knowhow as to ways in which the requested changes in the venture's system of activities can be implemented given its resources and capabilities). To sum up, CEO's perception of the efficacy of VC support may be related to VCs' ability to assist CEOs in reallocating their attention so that CEOs would be able to efficiently manage the transition.

In the first section, we have summarized the main sources of VC-CEO conflicts identified in research. Previous studies have shown that VC-CEO conflicts could stem from various causes. Some of them can be described as cognitive. For instance, VCs and CEOs may disagree on the strategic direction of the venture if CEOs are more focused on exploration and VCs are more concerned about exploitation of the discovered opportunities. In addition, VCs and CEOs may disagree about the pace of venture financing. While VCs practice staged investment to maintain maximum control over the venture and be able to save resources if it transpires that a venture is going to fail, CEOs may desire a more concentrated investment received in a shorter period of time and fear that

insufficient capitalization would put them at a disadvantage compared to the competition (Gomez-Mejia et al., 1990; Jog et al., 1991). Finally, VCs and CEOs often disagree in regards to the projected exit strategy. While CEOs often want to retain the venture as a standalone enterprise, VCs may prefer to sell it sooner to provide the liquidity for their own investors (Harris, 2010).

Thus, cognitive disagreements between VCs and CEOs regarding venture strategy, financing and projected exit may be quite significant. Such cognitive conflicts could also be affected by CEOs' concern about VCs' insufficient support. Prior studies have shown that VCs' attention is limited (Gifford, 1997), and may not be distributed effectively (Sapienza & Timmons, 1989; Shepherd et al., 2005). Furthermore, VC attention may be diluted due to quick portfolio growth (Cummings and Johan, 2007; Haagen, 2008). It is also known that CEOs often feel frustration with insufficient levels of VC support and attribute it to VCs' lack of experience in venture operations (Ehrlich et al., 1994; Barney et al., 1996). Finally, CEOs may become frustrated if they feel that their VCs have failed to help them with venture restructuring: while CEOs are required to change the way they apportion attention inside a venture by switching from exploration to exploitation, VCs may fail to assist CEOs in this transition. Hence, ineffective VC support (from a CEO's perspective) could add fuel to cognitive conflicts between VCs and CEOs. To summarize:

H1: CEOs' view of VC support as insufficient will be associated with CEOs' perception of the existence of cognitive conflicts between VCs and CEOs focused on venture strategy.

The Impact of VCs' Equity Share on Cognitive Conflicts between VCs and CEOs

VCs and CEOs actively negotiate before signing a contract as to what share of venture equity VCs will receive in exchange for their capital (Sahlman, 1990; Bell, 2009). Studies have shown that top-tier VC firms' support could be 10-14% more expensive (in terms of venture equity used to purchase it) compared to other VC firms (Hsu, 2005). Some VC, for instance, Perkins from the famous KP, have argued that it is irrelevant how much equity entrepreneurs agree to sell in the beginning because very few ventures will need money just for the first round of investment. Typically, ventures come back for more capital. Moreover, with each new round of financing, entrepreneurs' share dwindles and VCs' share increases. In this sense, the share of equity owned by VCs is related not only to VCs' bargaining power at the outset, but also to the venture's subsequent need in more capital and VCs' increasing equity share in the course of financing.

Obviously, as VCs acquire a greater and greater share of venture's equity, their ability to influence the venture's strategic direction increases. VCs' rising influence on the venture may exacerbate the cognitive disagreements between VCs and CEOs as VCs begin acting more imperially and

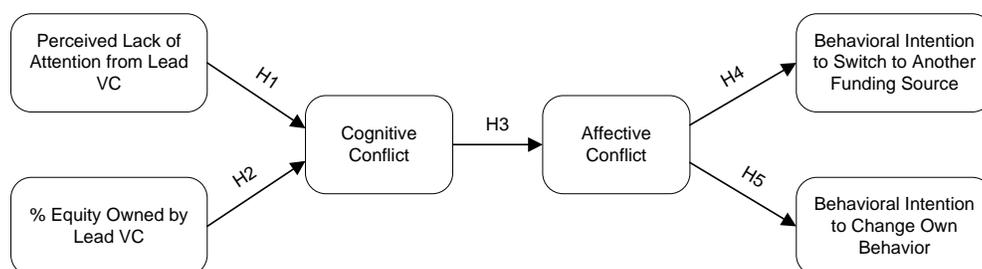
impose their strategic vision on CEOs. VCs, of course, do not run portfolio companies (except for the rare situations when VCs become interim CEOs). CEOs are still responsible for solving operational questions, but VCs' rising power could make CEOs more dependent on VCs so that CEOs would need VCs' approval on a wide range of operational issues. Put on a shorter leash, CEOs may resist VCs' tight control leading to greater cognitive conflicts. To summarize:

H2: VCs' equity share will be associated with cognitive conflicts between VCs and CEOs.

Cognitive Conflicts vs. Affective Conflicts

Recent research has emphasized the idea of conflict transformation over time. For instance, process conflicts occurring at early stages of a relationship may have a negative and long-lasting impact (Greer et al., 2008). Furthermore, conflicts may influence one another. Purportedly, cognitive conflicts may mediate the eruption of affective conflicts (Mooney et al., 2007). While affective conflicts are associated with relationship problems (Behfar et al., 2008), we believe that such conflicts may also stem from perceived injustices and improprieties attributed to certain roles and structural positions, rather than to individuals per se. For instance, it is

Figure 1: Research Model



possible that subordinates may resist the idea of being subjected to compliance procedures as not quite rational or humiliating, even though they do not have any personal problems with the particular supervisors. Therefore, while cognitive conflicts may relate to disagreements regarding goals and policies (Higashide and Burley, 2002), affective conflicts may arise in response to perceived inequities.

The second group of conflicts we identified in prior research could be especially conducive to the emergence of affective conflicts between VCs and CEOs. Thus, CEOs may become very emotionally involved and even agitated when discussing VCs' rigid control and interference with the venture (Cumming & Johan, 2007; Haagen, 2008). CEOs may also fear that they could be fired simply because VCs do not believe that they can learn how to manage a venture quickly enough (Willard et al., 1992; Flamholtz, 2004; Khanin et al., 2008). VCs, though, may feel that procedural justice has been violated if CEOs fail to provide them with needed information in a time manner (Sapientza & Korsgaard, 1996). Thus, collaboration failures can lead to strong emotional repercussions. VCs and CEOs may develop strong cognitive disagreements due to their discrepant vested interests that could be exacerbated by CEOs' view of VC support as insufficient. Cognitive conflicts, in turn, may result in affective conflicts if VCs and CEOs fail to address their collaboration problems. As a result, both parties may feel that procedural justice and their implicit psychological conflicts have been violated by rude, inconsiderate or indifferent partners (Parkahangas & Landstrom, 2006).

Thus, affective conflicts can be related to perceptions of fairness: both VCs and CEOs may feel that they have acted in good faith

and regard insufficient partner collaboration as unjust and offensive. The issue of control could become especially divisive due to VCs' insistence on tight oversight combined with the failure to provide substantial help that VCs may need to change their attention allocation patterns. Finally, VCs and CEOs may be inconsiderate and thus thwart collaboration. That may lead to escalation of conflict when the parties begin to view each other as a "selfish and destructive force" (Gorman & Sahlman, 1989) that can potentially hurt the new venture. This is why intense cognitive conflicts between CEOs and VCs may have adverse consequences. They may contribute to CEOs' feelings of anxiety and insecurity resulting in the perceived incompatibility between VC governance and CEOs' need to run their ventures most effectively. In turn, CEOs' inability to collaborate may cause equal dissatisfaction on the part of VCs. To summarize:

H3: Cognitive conflicts between VCs and CEOs will be associated with affective conflicts.

VC-CEO Affective Conflicts and CEOs' Plans for the Future

Venture capital may or may not represent the best choice of financing for entrepreneurs depending on their objectives, venture characteristics and other circumstances (Maula et al., 2005). First, recent findings indicated that those founders that have resorted to VC funding have generated less wealth for themselves post-IPO (Florin, 2005). On these grounds, Florin (2005) concluded that entrepreneurs primarily motivated by wealth creation for themselves – inventors in Perry's (1988) classification – could be better off if they received financing from other financiers than VCs. Ehrlich et al. (1994) compared VCs and private investors (PIs) in terms of

CEOs' perception of the value of these intermediaries' assistance, and established that while some CEOs appreciated the disciplining role of VC supervision, more seasoned entrepreneurs believed that it could be redundant and even suffocating. Maula et al. (2005) similarly contrasted CEOs' views on venture assistance provided by VCs in comparison to corporate venture capitalists (CVs). Other studies have examined the relative costs and benefits of receiving support from VCs as opposed to banks (Ueda, 2004). Finally, many studies have emphasized that different VC types exist (Elango et al., 1995) so that CEOs that are more selective in their choice of suitable types of VC firms as financiers could achieve greater satisfaction with VC assistance (Smith, 2001).

In considering possible sources of financing for their future ventures, CEOs (especially seasoned CEOs with successful track records) may have a number of choices. They could, in fact, avoid getting involved with VCs and choose instead to finance a venture on their own, or obtain financing from banks, private investors, corporate investors, etc. If seasoned CEOs decide to avoid VCs, this is certainly not a desirable outcome for VCs who prefer to deal with experienced entrepreneurs because the odds of their ventures achieving success are usually much higher (Hsu, 2005, 2007). Clearly, affective conflicts with VCs could steer CEOs in the direction of alternative sources of financing. On the other hand, CEOs may also reevaluate their own behavior and seek to improve their partner selection techniques, as well as to enhance the efficacy of their collaboration with VCs. Sapienza and Gupta (1994) showed the importance of openness and frequency of communication between VCs and CEOs for resolving their conflicts. CEOs could also

seek more experienced VCs in the future that would be able to furnish quality assistance to their companies. Finally, CEOs might decide to work harder on resolving conflicts with VCs; be alert to VCs' needs and provide requisite information to VCs in a timely fashion (Sapienza & Korsgaard, 1996; Sapienza et al., 2001), as well as become proactive in building their professional relationships with VCs in order to prevent conflict eruption and enhance collaboration. To summarize:

H 4a: Affective conflicts will be associated with CEOs' expectation that they would be more likely to use other types of financiers than VCs and/or other VCs to fund their future ventures.

H4b: Affective conflicts will be associated with CEOs' expectation that they would become more active in building collaboration with VCs for the sake of conflict prevention and resolution.

RESEARCH DESIGN AND METHODS

Procedure and Sample

Before launching our research project, we conducted a pilot study to identify both the common areas of disagreement between VCs and CEOs of portfolio companies and how CEOs may react to their conflicts with VCs in terms of their future choice of financing. Using Venture Xpert, a database of entrepreneurial ventures and VC firms maintained by Thompson Financial, we downloaded the entire population of ventures located in California that have received VC assistance from 2000 to 2008. Subsequently, an email was sent to 750 CEOs of companies residing in the neighboring counties with the request to

take part in a survey. The message contained a link to an online questionnaire. Overall, we obtained a random sample totaling 104 CEOs resulting in a 13% response rate. The majority of the respondents were men (91%). The vast majority had a master's degree (48%) or a college degree (34%). Only one person had no college education. Seventeen individuals held PhDs. The sample included ventures at different stages of development in terms of the classification used by Venture Xpert (from seed to bridge to acquisition) and with varying performance levels. Thus, 27 companies were in initial stages, 54 in an

expansion phase, 8 in "bridge" phase, and the remaining 14 were being acquired by competitors. The majority of ventures were not yet profitable (70.2%). However, the remaining 28.2% have already attained profitability. Only 6.8% of CEOs reported that they have achieved all the milestones set by VCs. Many more CEOs reported that their ventures have accomplished most of the VCs' milestones (60.2%). 33% of CEOs wrote they have met only some of their milestones. Further characteristics of the CEOs and their companies are given in Table 2.

Table 2: Demographic Characteristics of the Respondents.

Variable	Mean	Std. Dev.	Min	Max
Age	45.22881	6.172396	33	65
Gender	1.08526	0.2793357	1	2
Education	2.176782	0.6809352	1	3
Experience	22.2341	5.198991	10	40
Industry Ys	15.11224	6.874533	3	38
Technology Ys	7.660886	8.481682	2	38
Same team Ys	3.140173	1.18509	1	7
Prior ventures	2.604528	3.896883	0	20
Growth rate	22.30778	143.0371	0	1000
VC Equity %	30.8797	11.5851	16	70
Employees	65.43304	54.08007	0	300

The Survey

In order to test hypothesis 1, we included questions in our survey that were related to the perceived insufficient (or lacking) attention on the part of VCs allocated to the venture (from a CEO's perspective). Specifically, we used two items: 1) We feel that our VCs have not spent enough time on-site and 2) We feel that our VCs have not spent enough time answering our questions. Although we repeated these two

questions both for lead VCs and non-lead VCs, only lead VCs were retained for data analysis since CEOs indicated that non-lead VC support was less relevant. CEOs were instructed to answer the questions using the Likert-type scale ranging from 1 (highly disagree) to 7 (highly agree). We also constructed the three questions for the survey testing the emergence of cognitive conflicts between VCs and CEOs. All these items are presented in Table 3.

Table 3: The Measurement Instrument

Construct	Items	Text
Behavioral Intention to Switch to Another Funding Source	BIS1	Your venture would be better off had you avoided getting involved with VCs
	BIS2	Your venture would be better off had you chosen VCs more carefully
	BIS3	Your venture would be better off had you selected more experienced VCs
	BIS4	Your venture would be better off had you worked with VCs who had more operational experience
Behavioral Intention to Change Own Behavior	BIC1	Your venture would be better off had you have been more proactive in building your relationship with the VC/s
	BIC2	Your venture would be better off had you have worked more actively on resolving conflicts and disagreements with the VC/s
	BIC3	Your venture would be better off had you have been more attentive to the VC/s' requests
Affective Conflict	AC1	Our discrepancies with VCs concerned mostly fairness issues
	AC2	Our discrepancies with VCs concerned mostly control issues
	AC3	Our discrepancies with VCs concerned mostly relationship issues
Cognitive Conflict	CC1	Our discrepancies with VCs concerned mostly strategic decisions
	CC2	Our discrepancies with VCs concerned mostly exit decisions
	CC3	Our discrepancies with VCs concerned mostly financing decisions
Perceived Lack of Attention	LA1	We feel that the VC/s have not spent enough time on-site
	LA2	We feel that the VC/s have not spent enough time answering our questions
% Equity Owned by Lead VC	PE1	% of the venture that is owned by the lead VC?

Based on prior research, we established that cognitive conflicts between VCs and CEOs center on venture strategy (Rosenstein et al., 1993), and financing and exit (Sahlman, 1990; Higashide & Burley, 2002). The included items represent these three areas of cognitive discord that may arise due to parties' divergent views on venturing (exploration vs. exploitation) and discrepant interests (Sapienza & Gupta, 1994; Shane &

Cable, 1997; Cumming & Johan, 2007). In contrast, we used the items related to fairness, control and relationship issues to test affective, relationship-based conflicts since affective disagreements typically have to do with the perceived violations of equity, procedural justice, and implicit psychological contracts between VCs and CEOs (Parkahangas & Landstrom, 2006). The item measuring percentage of equity

currently used by VCs was included in the questionnaire. Percentage of VC vs. CEO equity, as we argued earlier, reflects the bargaining power of VCs at the outset, as well as their commonly increasing influence over the venture as more capital is transferred from VCs, and respectively, they become the de facto (and de jure) owners of the venture. While we were concerned about getting responses to the question, all CEOs replied and clearly did not perceive this information as too private. CEOs' behavioral intention to switch to another funding source was measured first of all with the question concerning a possible avoidance of VC support in the future since CEOs do have alternatives (Hsu, 2005; Florin, 2005). In addition, we tested VCs' intention to seek more experienced VCs, and VCs with greater operational experience since CEOs often express their disenchantment with less experienced VCs (often recent recruits) lacking knowledge of venture management (Ehrlich et al., 1994; Barney et al., 1996). Finally, we tested CEOs' intention to choose VCs more carefully since prior research indicated that CEOs that do more search feel happier with their choices (Smith, 2001). The intention to change their own behavior was measured with items that emphasized some possibilities for preventing conflicts from happening by being proactive in building a relationship with VCs from the outset, the positive effects of resolving conflicts as they arise, and responding in a timely fashion to VCs' requests in order to build collaboration. These items were generated based on the previous research on VC-CEO collaboration (Jog et al., 1991; Sapienza & Korsgaard, 1996; Sapienza et al., 2001).

Data Analysis and Results

Several analyses were conducted prior to

testing the hypotheses with the structural model. The viability of the model's constructs was assessed using (1) reliability estimates (Cronbach's Alphas), inter-construct correlations, and descriptive statistics, and (2) a confirmatory factor analysis (CFA) procedure that employs Anderson and Gerbing's two-step approach for estimating structural equation models (Anderson et al. 1988).

As one can see in Table 4, there is sufficient variation in the constructs, and the item-to-total correlations for all constructs exceed the recommended cutoff point of 0.35 (Fornell et al. 1981). The Cronbach's alphas, for almost all constructs, exceeded the commonly used cutoff of 0.7, thus demonstrating reasonable consistency and reliability. The Cronbach's alpha for Cognitive Conflict was slightly below the 0.7 threshold, but removing items could not have increased this value. Thus, all items for this construct were retained. Overall, it was concluded that constructs are sufficiently consistent and reliable, and that they have ample variation for statistical modeling.

Second, a CFA model was specified and estimated, as the first-step in the Anderson and Gerbing's procedure (Anderson et al. 1988), using the structural equation modeling facilities of AMOS. The model included the six constructs that were allowed to freely correlate with each other.

As can be seen in Table 4, the fit statistics for this model were adequate and met the recommended cutoff values.

Particularly, Comparative Fit Index (CFI) and Incremental Fit Index (IFI) values of over 0.95, combined with Root Mean Squared Error of Approximation (RMSEA) below 0.08 indicate good fit (Hu et al. 1999). The RMSEA in our case

Table 4: Constructs' Descriptive Statistics, Reliabilities, and Correlations

	Mean	Standard Deviation	Range of Item-to- Total	(1)	(2)	(3)	(4)	(5)	(6)
Behavioral Intentions to Switch	4.49	1.75	0.57 – 0.81	0.87					
Behavioral Intentions to Change Behaviors	4.63	1.68	0.79 – 0.85	0.54**	0.90				
Affective Conflict	4.60	1.65	0.76 – 0.85	0.46 **	0.49**	0.89			
Cognitive Conflict	4.28	1.34	0.43 – 0.50	0.54**	0.38**	0.66**	0.68		
Percived Lack of Attention	5.19	1.75	0.66 – 0.66	0.49**	0.38**	0.35**	0.35**	0.79	
% Equity Owned by Lead VC	33.82	19.41	NA	0.13	0.05	0.13	0.03	0.03	1.00

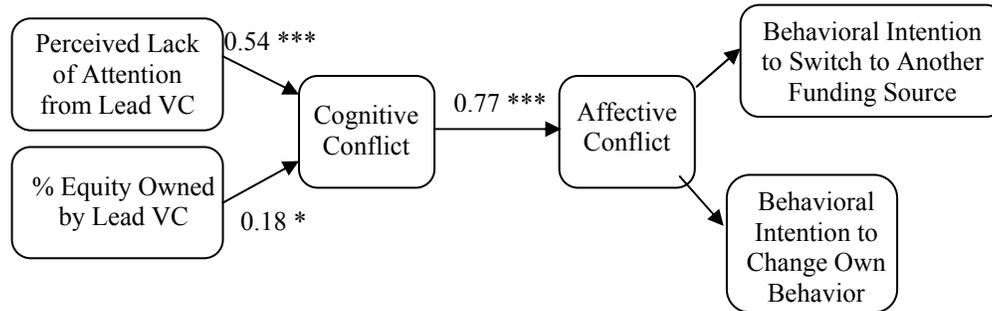
* $p < 0.05$ ** $p < 0.01$

is significantly below 0.05 (p-close < 0.058), which further indicates an excellent fit. In addition, the model passed all the condition-9 tests (Kelloway 1998: 28-29) since all the factor loadings were significant at $p < 0.00$. Given the viability of the CFA

model as demonstrated by its adequate fit indices and significant factor loadings, it was concluded that the structural model can be assessed. This model was therefore specified and estimated with AMOS. The fit statistics for this model are also outlined in Table 5.

Table 5: Fit Indices for the CFA and Structural Models

	χ^2	df	p-val	χ^2/df	IFI	TLI	CFI	RMSEA	p- Close
CFA Model (Step 1)	109.2	90	0.08	1.21	0.9 8	0.97	0.98	0.045	0.58
Research Model (Step 2)	131.2	98	0.01	1.34	0.9 6	0.95	0.96	0.057	0.31

Figure 2. Standardized Parameter Estimates for the Structural Model

* $p < 0.1$ ** $p < 0.01$ *** $p < 0.001$

As can be seen, the model has an adequate fit, as the fit indices meet the abovementioned criteria (CFI & IFI > 0.95, RMSEA < 0.05, factor loadings significant at $p < 0.001$). The model, standardized path coefficients and their levels of significance, correlations, and variance explained in endogenous constructs (SMC = Squared Multiple Correlations) are depicted in Figure 2.

To conclude, H1 and H2 posited respectively that the cognitive conflict between the CEO of a VC-backed company and the lead VC will be associated with insufficient VC attention, and the percent of equity owned by the lead VC. H1 received strong support ($p < 0.001$). In contrast, H2 received only marginal support ($p < 0.1$). However, the two hypothesized effects explain together 33% of the variation in cognitive conflict. H3 was also supported at $p < 0.001$. As conjectured, cognitive conflicts were also strongly associated with affective conflicts explaining 59% of the variation in affective conflict. H4 and H5 posited that the consequences of affective conflict can be (1) increased intention to switch to other funding sources, and (2) augmented intention to modify one's behavior and prevent or resolve conflicts with VCs, respectively. Both hypotheses were supported at $p < 0.001$. Affective

conflict explained 30% of the variation in financing intentions and 31% of the variation in CEOs' intention to improve their relationship with VC, respectively.

CONCLUSION

The main purpose of this paper was to examine the question that has been overlooked in the extant research on VC-CEO conflict (Higashide & Birley, 2002; Forbes et al., 2010): Do CEOs change their intentions in terms of seeking particular types of financial intermediaries for their future endeavors in the wake of conflict with VCs in their previous ventures? This paper's main contribution lies in demonstrating that, in reaction to conflict with VCs in their prior encounters, CEOs are likely to exhibit a wide range of behavioral intentions with regard to their choice of financial intermediaries going into the future. Specifically, some VCs may express the desire not to use any financial intermediaries; others may exhibit preference for business angels and CVCs rather than VCs; and still others could retain their previous intent to seek VCs as financial intermediaries, but also make the resolution to adjust their own behavior to avoid conflicts in the future.

;

The second contribution of this study is that it emphasizes, following some recent research (Zacharakis et al., 2010), the negative aspects of conflict, including cognitive conflicts frequently described in prior studies solely in positive terms (Higashide & Birley, 2002; Yitshaki, 2008). Previous researchers have approached cognitive conflicts from a positive perspective as genuine disagreements regarding venture policies that could lead to finding creative solutions for the benefit of the venture (Higashide & Birley, 2002; Yitshaki, 2008). In contrast, we argued that cognitive conflicts can be influenced by parties' vested interests, including their equity stake in the venture that could seriously aggravate such conflicts. VCs' equity stake is heavily negotiated before VCs and entrepreneurs enter their relationship (Sahlman, 1989; De Bettignies & Brander, 2006) and may further be changed multiple times depending on the degree of success of the venture and its need for new financing, often putting the entrepreneur at a disadvantage (Forbes et al., 2010). Not surprisingly, the divergent vested interests of VCs and entrepreneurs may underlie what appears on the surface as bona fide disagreements about venture strategies. The negative aspects of affective conflict arise not only due to the fact that relationships between VCs and CEOs of VC-financed ventures may seriously deteriorate as a result of personal frictions (Jehn, 1995; 1997; Jehn & Mannix, 2001). The negative aspects of affective conflicts, as we argue in this study, could also be due to the fact that either one, or even both, of the partners may believe that their expectations regarding procedural justice and fairness have been violated (Parhankangas and Landstrom, 2006; Sapienza et al., 2000).

Overall, this study shows that conflicts between VCs and CEOs should be approached seriously due to their potentially negative effect on VC-CEO collaboration and venture performance. Even cognitive conflicts should not be disregarded as being entirely positive or functional, but rather analyzed as possible symptoms of unfair equity distribution, ineffective collaboration or partner mismatch. Moreover, it is critical to follow the evolution of cognitive conflicts to avoid their escalation into even more intense affective conflicts that could make further collaboration between VCs and CEOs all but impossible. VCs also need to change their attitude toward conflicts as being only natural (Zacharakis et al., 2010) and be more alert toward the possible negative effect of conflict on their reputation, and hence, the quantity and quality of deals available to them in the future. Based on this research, CEOs also need to be very selective in their choice of financial intermediaries, as well as seek to ameliorate their own collaboration strategy.

LIMITATIONS AND FUTURE RESEARCH IMPLICATIONS

This study has some limitations. The reader should be aware of these limitations as they could affect interpretation of the results. First, many of our measures were based on CEOs' inherently subjective and emotional evaluations made in the wake of conflict with regard to VCs' perceived unfairness and intentions to choose to not to choose certain financial intermediaries in the future. Similar to other researchers (De Clercq and Sapienza, 2006), we sought to minimize such problems related to the subjectivity of used measures using established scales of different conflict types and relying on interviews with the

respondents to ensure better understanding of the underlying problems and conflictual issues in the VC-entrepreneur relationship. Nevertheless, the reader needs to realize that our findings could still be impacted by CEOs' subjective views of conflict. Furthermore, the reader needs to take CEOs' declarations made in response to our questions and open-ended comments on the survey, such as never to use any financial intermediaries in their new endeavors, with a grain of salt. CEOs could be frustrated and disappointed with their VCs and report their unwillingness to ever form alliances with VCs in the future. Still, CEOs might change their mind once they receive an attractive offer from a VC.

Furthermore, due to the cross-sectional nature of our data, any suggestions related to the causal nature of the observed relationship can only be speculative (Yli-Renko, Sapienza, and Hay, 2001). We are hopeful, however, that future research will shed additional light on the examined situations. Specifically, due to the contradictory nature of information regarding VC-CEO conflict, its antecedents, dynamics and outcomes received from VCs (Higashide & Birley, 2002; Yitshaki, 2008; Forbes et al., 2010; Zacharakis et al., 2010), it would be useful, in our view, to organize VC-CEO panels that could discuss the divisive issues and seek to capture their multiple dimensions taking into account both the vantage points of investors (VCs, business angels and CVCs) and entrepreneurs. More attention could also be devoted to clarifying the nature of the outcome variables, and investigating the extent to which entrepreneurs' (and VCs') determinations regarding future partner choice made in the wake of conflict were actually realized.

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Dr. Dmitry Khanin graduated from the University of Maryland with a Ph.D. in strategic management in 2006. Dr. Khanin's research is dedicated to various management disciplines including entrepreneurship, strategic management, family business, international business, organization theory, management education and business ethics. Dr. Khanin has published over twenty articles in such outlets as The Academy of Management Journal, Organization Science, Family Business Review, The Journal of Small Business Management, Venture Capital, Journal of Private Equity, Journal of International Entrepreneurship, Business Horizons, and others. Dr. Khanin is currently teaching organization theory and strategic management at Texas Tech University.

Dr. Ofir Turel is a professor of information systems and decision sciences at the College of Business and Economics, California State University, Fullerton. His research interests include a broad range of behavioral and managerial issues in various information systems contexts. He has published over 40 articles in journals such as MIS Quarterly, Journal of MIS, Communications of the ACM, European Journal of IS, Information & Management, Journal of Information Systems, Behavior & Information Technology, Telecommunications Policy, Group Decision and Negotiation, Family Business Review, and Communications in Statistics.

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