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CHAPTER III. VENTURE CAPITAL

ANTECEDENTS OF ENTREPRENEURS' TRUST IN THEIR INVESTORS (SUMMARY)

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Abstract

We examine how initial conditions shape entrepreneurs' trust in venture capitalists (VCs) in early versus later stages of relationships. Based on stage theories of trust (Lewicki et al., 2006), we suggest that the basis of trust changes with relationship stage. Factors that impact trust in newly-formed relationships may differ in more mature relationships. Although trust can strengthen or dissipate over time (Meyerson et al. 1996), few studies have attempted to empirically test whether factors that aid or inhibit trust in early stages have the same effects in more mature relationships. Our purpose is to address this gap. Specifically, we examine how factors hypothesized to influence trust shape the top management team's trust in VCs in newer versus older relationships. We examine two broad factors expected to influence entrepreneurs' assessments of the investor trustworthiness early on: (1) VC's reputation, and (2) the length and results of initial contract negotiations.

KEYWORDS: stage theories of trust, stages of relationships

SUMMARY

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Principal Topic

We examine how initial conditions shape entrepreneurs' trust in venture capitalists (VCs) in early versus later stages of relationships. Based on stage theories of trust (Lewicki et al., 2006), we suggest that the basis of trust changes with relationship stage. Factors that impact trust in newly-formed relationships may differ in more mature relationships. Although trust can strengthen or dissipate over time (Meyerson et al. 1996), few studies have attempted to empirically test whether factors that aid or inhibit trust in early stages have the same effects in more mature relationships. Our purpose is to address this gap. Specifically, we examine how factors hypothesized to influence trust shape the top management team's trust in VCs in newer versus older relationships. We examine two broad factors expected to influence entrepreneurs' assessments of the investor trustworthiness early on: (1) VC's reputation, and (2) the length and results of initial contract negotiations.

Method

Our sample is based on 181 VC-financed firms located in German-speaking Europe. We obtained data from three main sources: a survey of the CEO of the ventures, and two databases: Venture Economics and the CEPRES (www.cepres.de) databases.

Results and Implications

We found that trust is indeed affected by VC reputation, even before the relationship has had time to fully develop. Further, we found that the strength of the effect of reputation is different depending on the length of the relationship: the longer the relationship lasts, the greater the impact of VC reputation on trust. No direct relationship between the duration of negotiations and trust observed; however, as hypothesized, longer negotiations were associated with higher trust in newer relationships but associated with less trust in older relationships. Also as expected, accountability was negatively associated with trust in newer investment relationships but positively associated with trust in older relationships. Our results bring insight into the pattern of the development of trust over time from the entrepreneur's perspective. Thus it answers the call of Landström et al. (1990) for empirical and theoretical investigation into the pre-investment stages of VC-entrepreneur contract negotiation. Fourth, our work builds on several conceptual papers (e.g., Cable & Shane 1997; De Clercq & Sapienza, 2001; Zacharakis & Shepherd 2001), that highlight the need for more empirical work on the cooperation between investors and entrepreneurs. Finally, the results confirm earlier speculation on the role of initial conditions (e.g., Bocker, 1992) and extend these ideas to the role age of relationship in the emergence of trust (Lewicki & Bunker, 1996; McKnight et al. 1998).

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