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The optimal level of control in venture capital

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Abstract

The level of control required by venture capitalists in the portfolio enterprises they invest can have materially influence the trajectory of enterprise performance. Although VCs stress control to mitigate investment non-performance, intense control may avert the ability of ENs in maximising the enterprise's return on investment. An understanding into optimal level of control is evidently important. To gain an understanding into the optimal level of control in venture capital to enable the attainment of more optimal cooperative outcomes. This multiple case study research explored what the optimal level of control is, explore what moderating factors influence this optimum level, and explore what suggestions could achieve more optimal cooperative outcomes. By investigating optimality through a cooperative rather than a competitive exchange perspective to provide insights into how and why different allocation arrangements and exertion methods are applied across three cases of South African VCs operating different types of seed, start-up, growth, and development stage venture capital firms.

This research found that optimal level of control should satisfy the venture capitalist's financing constraint by enabling the venture capitalist to monitor and direct entrepreneur behaviour to ensure invested capital is used appropriately, while maximising the entrepreneur's incentives by being more relational than formal, more supportive than interfering, and more strategic than managerial. That the optimal level of control is a function of the venture capitalist's relative bargaining power, the venture capitalist's perceived level of trust and confidence in cooperation with the entrepreneur, and the venture capitalist's preferred approach, where the venture capitalist's preferences in conjunction with their own perceptions have the greatest influence. To achieve more optimal cooperative outcomes, venture capitalists and entrepreneurs should improve trust and confidence in cooperation by revealing private information new to the other and encouraging procedural justice by treating the other honestly and fairly.

Keywords

Venture Capitalist

Entrepreneur

Control

Allocation

Exertion

Declaration

I declare that this research project is my own work. It is submitted in partial fulfilment of the requirements for the degree of Master of Business Administration at the Gordon Institute of Business Science, University of Pretoria. It has not been submitted before for any degree or examination in any other University. I further declare that I have obtained the necessary authorisation and consent to carry out this research.

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Chapter 1: Introduction to Research Problem

1.1 Chapter outline

This chapter presents an introduction into the research problem. This chapter discusses:

- Selection of the problem
- Evidence of the problem
- The relevance of the topic
- The purpose and objectives of the research
- The scope of the research, and
- The business and theoretical need for the research

1.2 Selection of the problem

Distinctive discrepancies between entrepreneurs (ENs) and venture capitalists (VCs) make the VC-EN relationship problematic (Khanin & Turel, 2015). Stemming from substantial information asymmetries in conjunction with behavioural uncertainties, investments by VCs in promising and prospective ENs give rise to pronounced agency conflict (Amit, Brander & Zott, 1998; Burchardt, Hommel, Kamuriwo & Billitteri, 2016; Broughman & Fried, 2010). Motivated monetarily, VCs aim to achieve the highest possible return on their investment (Burchardt, Hommel, Kamuriwo, & Billitteri, 2016; Croce, D'Adda, & Ughetto, 2015) Given the considerable non-monetary private benefits associated with entrepreneurship, rationally the motives for and benefits extracted by ENs may not seamlessly align with the best return interest of time sensitive VCs (Burchardt, Hommel, Kamuriwo, & Billitteri, 2016; Douglas, 2013). VCs must mitigate a considerable collection of potential incentive conflicts from adverse selection and window dressing to moral hazard and holdup (Burchardt, Hommel, Kamuriwo, & Billitteri, 2016; Bruton, Fried, & Hisrich, 2000; Andrieu, 2012). Thus, downside protection is important, and to ensure alignment VCs see the necessity of continuous control in the enterprises in which they invest (Burchardt, Hommel, Kamuriwo, & Billitteri, 2016; Bruton, Fried, & Hisrich, 2000; Eldridge, 2007).

The level of control required by VCs can however materially influence the trajectory of enterprise performance (Davila, Foster & Jia, 2015; Semadeni & Cannella, 2011). The influence of control mechanisms is not without their drawbacks (Tan, Zhang & Xia, 2008). VCs who stress control experience fewer failures, however they realise fewer superior

successes (Wiltbank, Read, Dew & Sarasvathy, 2009). Intensive interference has been exposed to extinguish entrepreneurial enterprise (Cestone, 2014). With control mechanisms comes the incurrence of transaction costs, which can restrict the haste at which ENs can react and can put pressure on predicted performance (Dyer & Chu, 2003). Very restrictive control mechanisms intended to ensure investment performance constrain ENs by inhibiting them from fully enacting on emerging threats and opportunities (Wood & McKinley, 2010). Inappropriate control not only limits the ENs ability to deliver on strategic performance objectives but also impacts the EN's ability to effectively utilise provided resources (Lin, Chen & Lin, 2017). Thus, although VCs stress control to mitigate investment non-performance, intense control may avert the ability of ENs in maximising the enterprise's return on investment (Drover, Wood & Tyge Payne, 2014). Considering this, a fascinating question arises: What is the optimal level of control in venture capital? Exploring this further offers an obvious opportunity for research.

1.3 Evidence of the problem

As with other forms of private equity, exchange theory provides a useful lens through which to analyse venture capital transactions (Khanin & Turel, 2015). Venture capital transactions are not determined through the market forces of a liquid financial exchange (Heughebaert & Manigart, 2012). The process is a representation of extensive negotiations conducted over multiple rounds (Cumming & Dai, 2011). Motivated by mutual benefits that could be extracted from productive or cooperative exchange (Khanin & Turel, 2015). VCs and ENs enter an economic exchange of ownership where critical capital and promises of value-added assistance are committed for the relinquishment of a corresponding share of equity and its influence on direction and share of future returns (Khanin & Turel, 2015; Heughebaert & Manigart, 2012). Being a forward exchange transaction, venture capital returns are produced and allocated ex post (Hung, 2006). As a result, both VCs and ENs are exposed to exploitation by the other in conjunction with the prospect of enterprise failure (Cable & Shane, 1997; De Clercq & Sapienza, 2001; Gorman & Shaman, 1989).

With any investment decision investors are carefully trying to balance risk and reward. Logically VCs are no different. In making investment decisions two central risk components are taken into consideration by VCs in determining the enterprise's investment risk (Fiet, 1995). Firstly, market or performance risk which is the probability of success based on market conditions (Maxwell & Lévesque, 2011; Parhankangas & Hellström, 2007). Secondly, agency or relationship risk which is the probability of moral

hazard where the EN's future decisions and behaviours are contrary to the VC had the VC been in the same position as the EN (Maxwell & Lévesque, 2011; Parhankangas & Hellström, 2007). For example, the extraction of private rents such as using cash flows to cover personal expenses (Maxwell & Lévesque, 2011). The threat of divergence across valuation, strategic direction, pacing, resource allocation, risk assessment and exiting decisions is further complicated with neither party having complete understanding of the other's future intentions in conjunction with potential doubts about the other's competences and capability (Wijbenga, Postma & Stratling, 2007; Busenitz, Moesel, Fiet & Barney, 1997; Stratling, Wijbenga & Dietz, 2011). These perpetual differences in perceptions and familiarity with information between VCs and ENs result in suboptimal decision making (van Osnabrugge, 2000; Maxwell & Lévesque, 2011).

Naturally with any exchange transaction, the party with relative bargaining power will wield this over the other party to obtain an advantage (Heughebaert & Manigart, 2012; Cumming & Dai, 2011; Chahine & Goergen, 2011). Due to the significant experience differences characteristically found between ENs and VCs, VCs will exercise their financial and negotiation prowess disproportionately (Khanin & Turel, 2015). Typically structured in the form of a take it or leave it offer (Jia, 2015). The exchange process is a largely subjective determination made by the VC and is clearly structured in the VC's favour. While the level of control required is less influential than other determinants such as the enterprise's attractiveness and the EN's prestige during the investment decision, control is the principal instrument by which VCs can protect their investment (Drover, Wood & Tyge Payne, 2014).

Not necessarily concerned with managing day-to-day operations, the ability to control or alter the EN's actions to ensure adequate progress towards a desirable scenario is key for VCs (De Clercq, Fried, Lehtonen, & Sapienza, 2006). Not all potential conflicts of interest can be resolved *ex ante* (Burchardt, Hommel, Kamuriwo, & Billiteri, 2016). Due to the long-term nature of the VC-EN relationship, important variables must be omitted from contractual agreements as they are often very problematic or even impossible to define initially (Burchardt, Hommel, Kamuriwo, & Billiteri, 2016). To ensure alignment, VCs require substantial and vigorous control provisions in their arrangements with ENs (Drover, Wood & Tyge Payne, 2014; Tyge Payne, Davis, More & Bell, 2009). Although financial flows and corresponding control is obtained, VCs will require increased control beyond the level inferred in the financial transaction by insisting equity claims come with disproportionate control (Jia, 2015; Burchardt, Hommel, Kamuriwo, & Billiteri, 2016). VCs separately allocate cash flow and control rights to retain or relinquish control (Burchardt,

Hommel, Kamuriwo, & Billiteri, 2016; Kaplan & Stromberg, 2001). So, that even if the VC has a minority holding, he or she will maintain effective control (Jia, 2015).

In context of this binary exchange relationship between VCs and ENs, relationship risk is reciprocal (Arthurs & Busenitz, 2003). Emotionally and personally invested in the enterprises, ENs are not only driven by the desire for enterprise success (Khanin & Turel, 2015). Being an owner manager is a strong motivating factor (Andrieu, 2012; Hellmann, 1998). ENs want both the possibility of flexible future expansion and medium to long-term control over the enterprise (Burchardt, Hommel, Kamuriwo, & Billiteri, 2014). Decisions aimed at returning the most cash flow to investors can be contrary to the ENs best interest and despite this VCs still habitually impose them (Khanin & Turel, 2015). Inexperience disadvantages often make ENs defensive, suspicious, and unreasonable in their dealings with financially sophisticated VCs (Tyge Payne, Davis, Moore, & Bell, 2009). As a result, these behaviours make ENs vulnerable to some strategic and tactical blunders during negotiations. None of which is conducive to drawing VCs into more favourable agreements (Khanin & Turel, 2015).

1.4 Relevance of the topic

Enterprises with the potential to develop technological innovations key to delivering sustainable and more inclusive economic outcomes will require the raising of multiple rounds of extensive external finance to fund working capital requirements, further research and development initiatives, and fixed asset acquisition needs (Ning, Wang & Yu, 2015; van Osnabrugge, 2000; Pistoresi & Venturelli, 2015; Wang, Zhou & An, 2017). A classification of private equity financiers for the funding of early-stage EN enterprises normally associated with exponential growth, potential high levels of uncertainty, and pronounced asymmetric information discrepancies (Ning, Wang & Yu, 2015; Gompers & Lerner, 2001). VCs have emerged as an important intermediary for the provision of capital for these types of EN enterprises (Ning, Wang & Yu, 2015; Gompers & Lerner, 2001). That due to their characteristically small size, absence of assets which can be encumbered as security, and lack of a conclusive track record typically face increased difficulty in raising finance (Croce, D'Adda & Ughetto, 2015).

Investing in less than 1% of the enterprise proposals evaluated (Megginson & Weiss, 1991). Securing VC support emits a strong message of quality and has become one of the most sought-after achievements or precursors of success (Ragozzino & Blevins, 2015). VCs evidently excel in selecting successful enterprises. Observations reveal that

VC supported enterprises demonstrate remarkably enhanced performance with respect to their non-VC supported contemporaries (Barry & Mihov 2013; Bessler & Seim 2012; Di Guo & Jiang 2013; Rosenbusch, Brinckmann & Müller, 2013; Korteweg & Sørensen, 2010; Cochrane, 2005;). It would be incorrect to view venture capital transactions as a once-off commitment (Tan, Zhang & Xia, 2008). Although VCs evidently excel in selecting winners (Chemmanur, Krishan & Nandy, 2011; Sørensen, 2007; Baum & Silverman, 2004). Out performance of VC supported enterprises is not only attributable to selection of superior opportunities with more attractive potential trajectories (Alperovych & Hubner, 2012). Unique to VC transactions is the involvement of VCs as active investors during the post-investment period (Burchardt, Hommel, Kamuriwo, & Billiteri, 2016; Andrieu, 2012; Bottazzi, da Rin & Hellmann, 2008).

VCs do not just offer financial support (Croce, D'Adda, & Ughetto, 2015). VCs in fact play a dual role (Strauz, 2009). VCs are often heavily involved in the enterprises in which they invest and can exert constructive, neutral, or destructive influence (Fried, Bruton & Hisrich, 1998; Gorman & Sahlman, 1989). VCs can improve operational performance through improved recruitment of top management talent, the formulation and implementation of strategic and management initiatives, and the exploitation of their extensive networks to source partners, reach new clients and access key suppliers (Prosksha, Stranza, Röhrb, Ernstb, Pinkwarta & Schefczyk, 2017; Plummer, Allison, & Connelly, 2016; Alperovych & Hubner, 2013; Hellmann and Puri 2002; Bottazzi, Da Rin, and Hellmann, 2008; Hochberg, Ljungqvist & Lu, 2007; Ozmel, Reuer & Gulati, 2013). The presence of VCs intensifies the enterprise's normal performance to adjustments in underlying factors (Alperovych & Hubner, 2013). This is evidenced by VC supported enterprises enjoying enhanced returns in reaction to changing operating dynamics and capital structure adjustments (Alperovych & Hubner, 2013). Suggesting VCs add the most value with managerial advisory and capital structure management (Alperovych & Hubner, 2013). Taking into consideration the potentially limited ability, limited resources, and limited experience of first time ENs, VC support can be pivotal for the attainment of investment success (Burchardt, Hommel, Kamuriwo, & Billiteri, 2016).

Essentially a double-edged sword, the relationship brings both positives and negatives (Maula, Autio & Murray, 2009). On one hand ENs want to induce VC support for their enterprises in terms of professional advice and business connections (Cestone, 2014; Park & Steensma, 2012). On the other hand, ENs are discontent and demotivated when VCs interfere by exercising too much control on their enterprises (Cestone, 2014; Katila, Rosenberger & Eisenhardt, 2008). With VCs emphasising control to reduce downside

risk while allowing for upside potential, understanding the optimal level of control is evidently relevant in venture capital financial intermediation (Drover, Wood & Tyge Payne, 2014).

1.5 Purpose

The purpose of this research is to gain an understanding on the optimal level of control in venture capital to enable the attainment of more optimal cooperative outcomes. To achieve this, this research aims to:

- Explore what the optimal level of control is?
- Explore what moderating factors are influencing this optimal level of control? and
- Explore what suggestions could achieve more optimal cooperative outcomes

1.6 Scope

The scope of this three-case multiple case study research was limited to VCs operating different types of South African venture capital firms. The three types of venture capital firms presented in the cases for this study were:

- an independent Section 12J Venture Capital Company,
- a captive corporate, and
- an independent investment entity

1.6.1 Venture capital

Various expanded definitions of venture capital can be found which include later investment stages which incorporate greater debt financing instruments. For this research, venture capital has been limited to seed funding, start-up capital, development capital, and growth capital investment stages. Used for prototyping, seed funding is allocated to pre-start-up enterprises for the funding of research, and the evaluation and development of concepts or business models prior to the commencement of trading (SAVCA, 2017b). Used for set-up requirements, start-up capital is allocated to funding of new enterprises being set up (SAVCA, 2017b). Used for the development of pre-revenue enterprises, development capital is allocated to enterprises to further launch the enterprise after it has been set-up to support growing market share (SAVCA, 2017b). Used for the growth of post-revenue enterprises, growth capital is used for the funding of established high-risk enterprises in accelerating production, developing new

technology or products, or expanding into new markets (SAVCA, 2017b). According to the SAVCA 2015 Venture Capital Survey, start-up capital transactions are the predominant form of venture capital finance in South Africa accounting for 51 percent of South African venture capital transactions concluded from 2011 to 2015. Growth capital was next with 40 percent, followed by development capital with eight percent, and lastly seed funding with one percent (SAVCA, 2015). Where, as of 2016, start-up capital transactions accounting for 47 percent of all contributions for deals still invested (SAVCA, 2017b). Growth capital accounting for 37 percent and development capital and seed funding accounting for 12 percent and four percent respectively (SAVCA, 2017b).

1.7 The business need for the study

From a VC's position, an improved understanding into the aspects of control and its influence should positively assist with more prudent decisions by revealing potential considerations required for benchmarking their own evaluation and decision-making processes. Therefore, by improving their decision-making processes, more investors will feel confident in their assessment of VCs and as a result will be more likely to provide necessary funding to VCs to allocate to entrepreneurial enterprises (Maxwell & Lévesque, 2011). From an EN's position, an improved understanding into the VC decision-making process could enhance the probability of securing greater flexibility by optimising the level of control of required and exerted by VCs. This can provide insight into potential approaches ENs can apply to avoid repeating similar mistakes in their future financial intermediation and collaboration strategies (Khanin & Turel, 2015).

1.8 Theoretical need for the study

Inherently opaque because of the economic and social exchange relationship and active involvement of the VC post the investment decision (Burchardt, Hommel, Kamuriwo, & Billiteri, 2016; Khanin & Turel, 2015). An aura surrounding venture capital transactions cloaks the process in a certain mystique. Research into the venture capital industry continues to struggle due to the unwillingness of practitioners in sharing first hand data in conjunction with the industry's inherent opacity (Burchardt, Hommel, Kamuriwo, & Billiteri, 2016). Considering the increasing importance of VCs to the economy, employment, and innovation (Ning, Wang & Yu, 2015). The theoretical need for adding to the body of knowledge around achieving the most beneficial outcomes for VC-supported entrepreneurial enterprises is evidently important.

Extensive academic literature exists around optimal allocations of formal control rights between VCs and ENs (Aghion & Bolton, 1992; Bolton & Scharfstein, 1990; Dewatripont & Tirole, 1994; Hart & Moore, 1998). With an emphasis on how VCs can most appropriately govern their relations with ENs using formal monitoring, bonding, and incentives (Sapienza, Manigart & Vermeir, 1996). This has predominantly been investigated through a contracting theory perspective using a competitive exchange outlook. Regardless of the approach, literature discussing optimal allocations through contracting share the assumption that one party has absolute bargaining power in reaching optimal equilibrium allocation outcomes (Koskinen, Rebello & Wang, 2014). Arguing optimality in terms of concluding contracting agreements based on equilibrium allocation outcomes determined by bargaining power is logically limited. Although it provides a perspective from which to understand how formal contracts can be optimally concluded, it is limited in explaining how to achieve the enterprise's maximum potential benefit for both parties.

Theoretical predictions on the application of control rights has shifted from formal allocations grounded on contingencies to the consideration of actual VC interference in the enterprises in which they invest (Dessein, 2005). A VC's ability to monitor and direct an EN's actions is not exclusively determined through the allocation of formal control mechanisms. Cumulative consideration is being focused on what aspects of VC involvement influence the outcomes of VC supported EN enterprises (Ragozzino & Blevins, 2015). As relations between VCs and ENs cannot be formally controlled, an understanding into the optimal level control should incorporate how the allocation and exertion of informal control mechanisms in combination with formal control mechanisms should be best balanced (Shepherd & Zacharakis, 2001). By investigating optimality through a cooperative exchange perspective rather than a competitive exchange perspective this research can provide insights into the different allocation arrangements and exertion methods and how they are weighted by a sample of VCs.

Most of the academic literature on VCs has been conducted in the United States (US), logically as the venture capital movement was pioneered there and VCs in other countries have adopted this model (Morris, Watling & Schindehutte, 2000). With very little information on the relatively young venture capital industry in South Africa (Morris, Watling & Schindehutte, 2000). Expanding the geographical coverage to South Africa would offer an improved understanding of the context-dependent nature of exchange and contracting practices (Burchardt, Hommel, Kamuriwo, & Billiteri, 2016).

1.9 Chapter summary

This chapter presented an introduction into the research problem by providing background on the research problem, what the research objectives are, and the motivations for the research. Given the importance of VCs as active investors in conjunction with complex transaction conditions characterised by imbalances, uncertainty and incentive conflicts. An understanding into optimal level of control is evidently important to improve the reduction of downside risk without adversely affecting upside potential in venture capital exchange transactions. To gain an understanding into the optimal level of control in venture capital to enable the attainment of more optimal cooperative outcomes. This multiple case study research aims to explore what the optimal level of control is, explore what moderating factors influence this optimum level, and explore what suggestions could achieve more optimal cooperative outcomes. By investigating optimality through a cooperative rather than a competitive exchange perspective to provide insights into how and why different allocation arrangements and exertion methods are applied across three cases of South African VCs operating different types of seed, start-up, growth, and development stage venture capital firms. The three types of venture capital firms presented in the cases for this study were an independent Section 12J Venture Capital Company, a corporate captive, and an independent investment entity. The next chapter presents the argument of the research with reference to venture capital literature.

Chapter 2: Literature review

2.1 Chapter outline

To gain an understanding into the optimal level of control in venture capital to enable the attainment of more optimal cooperative outcomes. This multiple case study research aims to explore what the optimal level of control is, explore what moderating factors influence this optimum level, and explore what suggestions could achieve more optimal cooperative outcomes. By investigating optimality through a cooperative rather than a competitive exchange perspective to provide insights into how and why different allocation arrangements and exertion methods are applied across three cases of South African VCs operating different types of seed, start-up, growth, and development stage venture capital firms. The three types of venture capital firms presented in the cases for this study were an an independent Section 12J Venture Capital Company, a corporate captive, and an independent investment entity. Having presented an introduction into research problem by providing background, what the research objectives are, and the motivations for the research. This chapter presents the argument of the research with reference to venture capital literature. From this review propositions are put forward regarding what the findings are likely to be in exploring the research objectives. The chapter reviews:

- The types of venture capital firms
- The optimal level of control
- The moderating factors influencing the optimal level of control, and
- Suggestions to achieve more optimal cooperative outcomes

2.2 The types of venture capital firms

VCS come in many shapes and forms. Although inherently risky with extremely high failure rates (Nahata, Hazarika & Tandon, 2014). The opportunity to make exponential returns against a backdrop of low yields, stagnant markets and an abundance of liquidity, has attracted more and more interest from non-traditional players (Lerner, Hardymon & Leamon, 2012; SAVCA, 2017). VCs can include both individuals such as wealthy entrepreneurs and angel investors, and entities such as private equity firms, family offices, investment managers, banks, and listed entities and their subsidiaries (Lerner, Hardymon & Leamon, 2012). Research typically observes two principle types of venture capital firms. Independent firms who raise funding from independent third-party investors and captive firms who are dependent on financing from a parent entity. It is important to

differentiate between these types of firms as this also provides insight into how they invest.

2.2.1 Captive funds

Known as on-balance sheet investors, captive firms are typically subsidiaries or larger parent entities such as large institutional investors, pension funds, insurance providers, asset managers and banks, as well as other larger listed and unlisted entities (Andrieu & Groh, 2012). Often managing their parent entity's capital exclusively, both their source of capital and affiliation are important in determining a captive firm's investment objectives and approach (Andrieu & Groh, 2012). Captive firms are typically classified as government, corporate or other in accordance of where their funding is primarily sourced from (SAVCA, 2017b). Captive firms typically pursue the strategic objectives of their parent entities seeking complementarities with other activities of the entity than the ultimate financial performance of the venture (Hellmann, Lindsey & Puri, 2008; Andrieu & Groh, 2012). As a result, captive firms can have longer investment horizons with reduced exit pressures (Chemmanur, Loutskina & Tian, 2014; Guo, Lou & Perez-Castrillo, 2014). Captive firms are not without their drawbacks. On-balance sheet firms have come under increased regulatory pressure on the cost of perceived riskier capital (Catalyst, 2014). Regulations such as Basel III have seen many captive firms especially those of banks be subsequently spun out (Catalyst, 2014).

2.2.2 Independent funds

Independent firms are the dominant fund structure in the US (Croce, D'Adda, & Ughetto, 2015). Although alternative structures exist. The dominant independent firm type found in the US is the limited partnership (Andrieu & Groh, 2012). In this type of firm structure, several investors called limited partners commit capital to a fund with a limited lifespan typically between seven and ten years (Andrieu & Groh, 2012). Managed by VCs who are referred to as the general partner, once sufficient funding has been raised, VCs seek out promising and potential entrepreneurial enterprises in which to invest (Andrieu & Groh, 2012). Eventually divesting and returning proceeds to their investors (Andrieu & Groh, 2012). VCs operating this firm structure must raise a subsequent fund to continue investing (Andrieu & Groh, 2012). Faced with intense pressure to deliver adequate and appropriate return, VCs operating independent firms are solely motivated by financial gain (Andrieu & Groh, 2012; Chemmanur, Loutskina & Tian, 2014). Independent firm structures include both traditional structures such as *en commandite* partnerships, and

non-traditional alternatives such as Section 12J Venture Capital Companies (VCCs), Special Purpose Acquisition Companies (SPACs), and Investment Entities (IEs) (SAVCA, 2017a).

2.2.2.1 en commandite partnerships

Although the principle structure for housing South African private equity funds with a South African investment focus (Loubser, Viviers & Minnaar, 2013; SAVCA, 2017). *En commandite* partnerships are not the most popular firm structure amongst venture capitalists. *En commandite* partnerships are established by contract and have two types of partners (Portmann & Mlambo, 2013). The disclosed general or managing partner who manages the firm and the undisclosed limited or en commandite partners who merely contribute capital and are not involved in the management of the firm (Portmann & Mlambo, 2013). Governed by the conditions contained in the partnership agreement (Loubser, Viviers & Minnaar, 2013). General partners will levy a management fee to cover operating expenses and share in the profits through carried interest (Kudanga, 2015). Unlike companies which can have perpetual existence, typically these structures are operated for 10 to 12 years and then wound up by agreement (Kudanga, 2015). As a result, to continue investing, VCs establish a subsequent firm and raise funding to continue investing. According to Loubser, Viviers and Minnaar (2013), these partnerships are utilised for the following reasons –

- The firm's third-party investors or en commandite partners are afforded limited liability, and as a result will not be liable for any amounts exceeding the contractual commitment of the fund
- Through the conduit principle, taxation of income and capital gains are in done in the hands of the investors in accordance with their own unique tax profiles
- Relative easy to establish, the investment manager is permitted with a high degree of autonomy as these partnership structures allow for the operational day-to-day matters to be outsourced as they are not subject to cumbersome legislation, regulation or oversight
- Commonly used international practices and contractual terms can be applied

2.2.2.2 Section 12J Venture Capital Companies

Introduced in 2008 to assist new privately owned entrepreneurial enterprisers in terms of access to equity finance and enhance the attractiveness of venture capital as an

investment asset class (Linington, 2016; SAVCA, 2014). Section 12J of the Income Tax act provides for the establishment of an investment holding vehicle described as a Venture Capital Company to allow for the pooling of retail and institutional investor capital to fund a portfolio of interests (Linington, 2016; SAVCA, 2014). To encourage investment in VCCs, tax incentive legislation has been implemented for investors to claim the full price incurred in the subscription of VCC shares as a reduction of income where there is no recoupment of the tax rebate should the investor holds the shares for longer than 5 years (Linington, 2016; SAVCA, 2014). VCCs must then allocate most of the subscription capital received within three years by subscribing for shares in target investee enterprises in accordance with specified investment criteria (Linington, 2016). According to SARS (n.d.) these investment criteria include:

- A maximum threshold of 20% of the capital raised through the issue of shares in the VCC may be subscribed into any one investee enterprise
- 80% of the capital raised through the issue of shares must be allocated in qualifying investee enterprises. Qualifying investee enterprises are classified as follows:
 - The investee enterprise must be a private company with a limit on total book value of assets of R50 million or a junior minor company with a limit on total book value of assets of to R500 million
 - The investee enterprise must be resident in South Africa and cannot be a controlled group company in relation to a group of companies
 - The investee enterprise must have tax affairs in order and during any year of assessment aggregated investment income derived must not exceed 20% of its gross income for that year
 - The investee enterprise cannot not operate in any the following impermissible trades investment holding companies, property holding companies, firms of professionals, banks, short term insurers, financial service providers, companies involved in gambling, alcohol, tobacco, arms or trade carried mainly outside South Africa
- An investee enterprise cannot be considered a controlled group enterprise as a result a VCC cannot hold more than a 70% equity share in an investee enterprise

The advent of this firm structure has seen the significant inflow of new capital contributions into venture capital as an asset class with SARS recording 49 VCCs raising R1.8 billion from 892 investors (SAVCA, 2017b). Although targeted at enhancing venture capital, these investment vehicles are suitable for any private equity investments that

meet the prescribed investment criteria (SAVCA, 2017b). As a result, the application has been more broadly focused on equity investments in small and medium sized enterprises operating at varying stages of the investment lifecycle (SAVCA, 2017b).

2.2.2.3 Special Purpose Acquisition Companies (SPACs)

A publicly traded investment holding company with the specific mandate of merging with or acquiring other investments (SAVCA, 2017a). SPACs provide an efficient and cost method of raising capital (SAVCA, 2017a). Permitted with two years to raise sufficient capital, a SPAC is not permitted to carry on any commercial or business operations during the application for listing (SAVCA, 2017a). As a result, SPACs cannot come to the market with investments and investors are essentially back a management team and its funding strategy (SAVCA, 2017a). To list on the main board, SPACs require R500 million and R50 million to list on the AltX (Bellew, 2017). Held in an escrow account, the first investment made must be approved by the underlying shareholders with a 75% majority of the votes cast (SAVCA, 2017a; Bellew, 2017). Failure will result in the return of capital, delisting and winding up of the SPAC (Bellew, 2017).

Not bound by lock-ins prevalent in limited partnerships, SPACs provide both investor liquidity and protection of funds raised (SAVCA, 2017a). Where if no viable asset is acquired there is a minimum liquidation value per share (SAVCA, 2017a). With no specific time frame, there is no looming pressure to exit because of an artificial deadline allowing portfolio companies greater opportunity to achieve necessary scale (Voigt, 2016). To ensure alignment, SPAC directors have a mandatory co-investment obligation where they must hold at least 5% in the investment vehicle which is locked in for a minimum of six months post the acquisition of the first viable investment (Voigt, 2016; SAVCA, 2017a). The Board of directors in charge of investments must also have satisfactory and sufficient experience in the management of the viable investments to be acquired and can only amend acquisition investment criteria through a 75% majority of the votes cast (Bellew, 2017).

2.2.2.4 Investment Entities (IEs)

Also known as permanent fund vehicles, to allow for longer life spans than permitted in partnerships, investment entities are often more appealing for certain investments and markets where it may take longer to reach sufficient scale (SAVCA, 2017a). Either a private entity such as a company or trust, or publicly listed (Bellew, 2017). Unlike SPACs,

IEs can come to market with a portfolio of investments (SAVCA, 2017a). Should the entity be listed, it must have R50 million subscribed permanent capital and classified in the investment companies sub-sector of the FTSE Global Classification System (Bellew, 2017). No material trading or speculation can be conducted by the entity and gains achieved must be derived through securities and equities portfolios with an adequate spread of portfolio risk (Bellew, 2017). Most of the board will need to be independent to show it will act independently from the investment manager (Bellew, 2017). However, like SPACs there is alignment with the interests of investors as the investment managers must hold an interest in the IE of 10 percent and the investment policy specified during the pre-listing can only be changed through shareholder approval at a general meeting (SAVCA, 2017a; Bellew, 2017). As with SPACs, listed IEs investment managers must have adequate experience (SAVCA, 2017a; Bellew, 2017).

2.2.3 The South African venture capital landscape

One of the greatest challenges for research on VCs in South Africa is that there is very little information since the venture capital industry is relatively young (Morris, Watling & Schindehutte, 2000). Early-stage funding was previously noted as almost non-existent (Jones & Mlambo, 2013). It has however been noted that South Africa's venture capital ecosystem is evolving with more firms entering the industry and growing investor interest in venture capital as an alternative asset class (SAVCA, 2017a). Corporate venture capital is increasing, especially amongst banks and financial services companies trying to keep abreast of digital disruption by supporting incubators and investing in start-ups especially in fintech space (SAVCA, 2017a). Angel investment activity has also emerged from the edges to become a central allocator of capital for early stage entrepreneurial enterprises (SAVCA, 2017b). According to the SAVCA 2015 Venture Capital Survey, private-sector captive firms have dominated South African venture capital transactions accounting for 46 percent of South African venture capital transactions concluded from 2011 to 2015. Captive government firms were next with 44 percent, followed by angel investors and private-sector independent firms with five percent each (SAVCA, 2015).

2.3 The optimal level of control

As many diverse control mechanisms can be employed by VCs, an understanding of control is required to appreciate the importance of this variable to the success of the VC-EN exchange relationship (Tyge Payne, Davis, More & Bell, 2009). In exploring what the optimal level of control in venture capital is, rationally we need to understand what control

is, how control is allocated, and how control is exerted. This section reviews academic literature on what control is, how control is allocated, and how control is exerted. From this review, a proposition is put forward regarding what the findings are likely to be in exploring what the optimal level of control is.

2.3.1 Control

VCs are concerned with the level to which they can mitigate behaviour uncertainties and agency conflicts to deliver on desired objectives (Drover, Wood & Tyge Payne, 2014). Control can therefore be considered as the VC's ability to monitor and direct an EN's actions during the post-investment period to ensure invested capital and resources are being employed appropriately (Kaplan & Strömberg, 2003; Tyge Payne, Davis, More & Bell, 2009; Geringer & Hébert, 1989). VCs gain and exert control through formal and informal control mechanisms. Formally through the increasing reliance on elaborate contracts and incentivisation and informally through reciprocal relationships and cooperation based on relational norms and trust (Strätling, Wijbenga & Dietz, 2011; Yitshaki, 2012).

2.3.2 Allocation of control

Attaining and shifting control is a main motivation in venture capital and private equity transactions (Fluck, 2010). Allocation of control rights between VCs and ENs is supposed to secure an attractive return for VCs while adequately providing for the optimal exertion of effort from the EN (Burchardt, Hommel, Kamuriwo, & Billiteri, 2016). Formal control is first obtained through the equity stake purchased. Because of elevated levels of uncertainty about returns in conjunction with substantial information asymmetry, VCs will exercise their financial and negotiation prowess disproportionately (Khanin & Turel, 2015). VCs will excessively discount cash flow projections of the proposed enterprises thus capturing more favourable equity positions and the corresponding influence on control (Douglas, Carlsson-Wall & Hjelstrom, 2014). Although a level of control is obtained, VCs will require increased control beyond the level inferred in the financial transaction by separating the allocation of cash flow and control rights (Burchardt, Hommel, Kamuriwo, & Billiteri, 2016; Kaplan & Stromberg, 2001). Set out in contracts with an extensive arrangement of conditions and requirements (Eldridge, 2007). Allocation of control rights are classified as contingent, unilateral or joint (Wang, Zhou & An, 2017). Formal control mechanisms can be categorised into output controls

contingent on performance and behavioural controls specifying and monitoring acceptable boundaries of conduct (Maxwell & Lévesque, 2011).

Adhering to their role as active investors, VCs require board, voting, veto and other decision rights to influence the strategic direction of the enterprise (Burchardt, Hommel, Kamuriwo, & Billiteri, 2016). These typically include the reservation of board seats, the ability to block or veto certain types of management and board decisions around spending, acquisitions, disposals and business plan implementation, and the ability to appoint and alter members of the management team and alter their compensation structure. In addition to these decision rights, VCs also require other control rights in regards to the protection of their equity holding and controlling the exit such as participation, anti-dilution, redemption, pre-emption, drag along, tag along, and other liquidation preferences (Burchardt, Hommel, Kamuriwo, & Billiteri, 2016). These typically include the ability to participate in future financing rounds to maintain equity holding, having first right of refusal for the sale of any holding, the ability to exercise liquidity rights to prevent hold-up, the ability to sell back holding to the EN after a predetermined period and a predetermined price, the ability to reprice the EN's equity stake if following financing rounds yield lower valuations, the ability to include holding in the sale by any other shareholders, and the ability to bring along other shareholders to a sale (Barney & Busenitz, 1996; Hellmann & Puri, 2002; Hellmann, 1998; Sahlman, 2003; Jia, 2015; Burchardt, Hommel, Kamuriwo, & Billiteri, 2016; Cumming & Johan, 2007).

From an incomplete contracting theory perspective, contracts are considered incomplete due to bounded rationality and transactions costs (Grossman & Hart, 1986; Hart, 1995; Tirole, 1999). Naturally, contracts cannot account for every decision that will need to be made by the entrepreneurial enterprise (Yerramilli, 2011). As a result, incomplete contracts provide only partial protection against moral hazard advocating that the ex-post allocation of control that matters (Yerramilli, 2011). Motivated monetarily, VCs seek downside protection (Burchardt, Hommel, Kamuriwo, & Billiteri, 2016). Key is the ability to vary the level of control contingent on performance (Jia, 2015). Applied through a combination of staging, convertible securities and complementary contractual covenants, the distribution of cash flow and control rights is typically contingent on the fulfilment of financial and non-financial performance measures during episodic EN evaluations (Burchardt, Hommel, Kamuriwo, & Billiteri, 2016; Cornelli & Yosha, 2003; Kaplan & Strömberg, 2004; Tian, 2011). Unlike debt-financing, these contingencies never include financial covenants specifying interest cover, working capital or net asset value levels (Bengtsson, 2011). VCs structure contractual agreements to specify

performance milestones as benchmarks for evaluating portfolio enterprise performance in respect of enterprise pacing of business plan implementation (Bengtsson, 2011). Positively related to variations in agency costs (Burchardt, Hommel, Kamuriwo, & Billiteri, 2016). The use of contractual contingencies by VCs is therefore particularly prominent for earlier-stage, R&D-intensive, and pre-revenue types of EN enterprises where large amounts of investments are required preceding production (Jia, 2015).

The application of control-shifting covenants by VCs thereby intensifies their influence on strategic direction by enabling them to take significant control if suboptimal performance or unanticipated opportunistic behaviour ensues (Kaplan & Strömberg, 2004; Burchardt, Hommel, Kamuriwo, & Billiteri, 2016). Thereby mitigating the consequences of incomplete contracts through the introduction of sanctions and realisations (Colombo, Grilli, & Piva, 2006; Lerner, 1994). Also applied conversely, VCs with a preference for higher levels of initial control will transfer rights to the EN as enterprise performance improves (Dewatripont & Tirole, 1994; Fluck, 2010). Expectation of these allocations of rights ex post incentivises ENs performance ex ante thereby improving the probability of potential success. In practice, most control rights are unconditional as the VCs ability to exercise these rights are generally not limited by contingencies (Kaplan and Strömberg, 2003; Sahlman, 1990).

A prevalent feature of financial contracts, downside protection through the separation of ownership and control has been motivated as an optimal solution to adverse selection and moral hazard challenges (Bengtsson & Bernhardt, 2014b). As VCs could force ENs to make preferred decisions by threatening to discontinue their financial or value-adding support, it could be argued that VCs do not require the protection provided by performance covenants (Bengtsson, 2011). However, due to the extensive formal contractual provisions employed, VCs are exposed to hold-up and renegotiation concerns (Bengtsson, 2011). VCs want the ability to take control of the enterprise in case of poor performance, and full control of their own exit in case the enterprise progresses positively (Burchardt, Hommel, Kamuriwo, & Billiteri, 2016). Optimal contracting should therefore provide the VC residual control rights or specific control rights in the form of contingencies should this not be optimal or feasible (Bengtsson, 2011). However contingent protection can promote the VC in making more self-serving decisions that expropriate the EN and whether they are optimally allocated in venture capital transactions is an evident opportunity for further research (Bengtsson, 2011). Venture capital contracts imply an evolution of control rights over time. VCs relinquish the right to interfere in decision over time but in return obtains valuable rights in course of the

financing relationship (Burchardt, Hommel, Kamuriwo, & Billiteri, 2014; Fluck, 2010). VCs typically have control however as performance milestones are met they forgo their superior voting, board, and liquidation rights. Should convertible securities be employed, preferred equity is also subsequently converted into common equity (Cestone, 2014).

Real-world evidence relating to the optimal allocations of control rights between VCs and ENs is rare (Bengtsson, 2011). US data clearly demonstrates that convertible preferred equity is the fundamental financing instrument employed almost exclusively in venture capital investment transactions (Burchardt, Hommel, Kamuriwo, & Billiteri, 2016). However, in contrast to the US, convertible securities are not the dominant form of financing in South Africa with common equity predominantly employed to finance portfolio entrepreneurial enterprises (Huyghebaert & Mostert, 2008). Prevalent in the US, internationally liquidation rights are not a predominant form of venture capital financial intimidation (Leisen, 2012; Lerner & Schoar, 2005, Kaplan, Martel & Strömberg, 2007). In declining order, the following control provisions have been found to apply in more than half of the contracts used by VCs in South Africa during seed and start-up stages; Assigning seats on the board, assigning majority voting rights to influence strategic enterprise decisions, obliging ENs to sign non-compete contracts, vesting EN shares over an extended period, and staging finance in several rounds contingent on the fulfilment of prescribed objectives (Huyghebaert & Mostert, 2008).

Literature consistently considers control as an inseparable right that can only be held by the VC or EN at any given time (Kirilenko, 2001). While the provision of value added benefits is positively related with the equity stake held, intervention by VCs increases as the VC's control increases (Cumming & Johan, 2007). Where anxiety about failure results in VCs interfering unduly in the governance of enterprises in which they invest (Bonini, Alkman & Salvi, 2012). It is argued that a hierarchy of control should exist (Broughman, 2013). Logically, control rights should ideally be allocated to the party which has the greatest marginal ability to influence the returns (Eldridge, 2007). As ENs typically have access to better private information regarding the enterprise, this line of argument implies the natural controller of the enterprise should be the EN (Eldridge, 2007; Broughman, 2013). Therefore, control should be allocated to the EN whenever possible (Aghion & Bolton, 1992; Broughman, 2013). However, increased investor control may be required to satisfy the investor's financing constraint (Broughman, 2013). Optimality in the allocation of control rights should therefore provide the best possible incentives for the EN but still satisfies the VC's financing constraint (Yerramilli, 2011).

2.3.3 Exertion of control

VCs place importance on the utilisation of intricate and stringent formal mechanisms for the control of entrepreneurial enterprises (Van den Berghe & Levrau, 2002; Zahra, Yavuz & Ucbasaran, 2006). With many VCs of the belief that these formal mechanisms can be utilised as an appropriate substitute for relational means of control that are constructed on interpersonal relationships and informal goodwill (Klein Woolthuis, Hillebrand, & Nooteboom, 2005; Nooteboom, Berger & Noorderhaven, 1997; Strätling, Wijbenga & Dietz, 2011). Agency theory asserts that the VC-EN relationship is most appropriately managed using formal contractual agreements to ensure alignment (Yitshaki, 2012). This perspective however tends to ignore the potential benefit available in the relationship after the establishment of the formal contract (Arthurs & Busenitz, 2003; Yitshaki, 2012). Setting out expectations regarding the collaborative effort, ENs and VCs enter a social exchange as mutual partners who must develop shared trust and cooperation (Shepherd & Zacharakis, 2001; Zacharakis, Erikson & George, 2010).

The VC-EN relationship is critical to the success of entrepreneurial enterprises (Tyge Payne, Davis, More & Bell, 2009). In these relationships, both parties need each other (Cable & Shane, 1997). Both VCs and ENs must place reliance on the expertise and resources brought by the other (Strätling, Wijbenga & Dietz, 2011). As relations between VCs and ENs cannot be formally controlled, under conditions of high interdependence and high levels of uncertainty, confidence and trust in cooperation becomes crucial (Cable & Shane, 1997). Although not sufficient for enterprise success in isolation, a feasible solution of cooperation between the VC and EN is a compulsory condition for the success of VC-supported enterprises (Middelhoff, Mauer, Brettel, 2014; Cable & Shane, 1997). The inability to develop effective working relationships is regularly regarded as a leading reason behind failed EN enterprises (Nahata, Hazarika & Tandon, 2014). More critical than the actual advice provided by the VC, is the acceptance of that advice by the EN (Faber, Castaldi & Muskens, 2016). Effective support can be considered dependent on better relation fit (Faber, Castaldi & Muskens, 2016). Better relational fit stimulates more open exchanges between the VC and EN enhancing enterprise performance through enabling better monitoring and the provision of appropriate support (Faber, Castaldi & Muskens, 2016).

Venture capital investment transactions rely on relational norms where it is suggested that the VC-EN relationship is impacted more meaningfully through interaction and reciprocal relationships rather than through formal mechanisms of control (Sapienza &

Korsgaard, 1996; De Clercq & Sapienza, 2001; De Clercq & Sapienza, 2006; Busenitz, Fiet, & Moesel, 2004). Relationship conflict is particularly damaging to performance as both parties to the exchange reduce collaboration and squander resources on non-task related problems (Brettel, Mauer & Appelhoff, 2013; De Dreu 2006). The importance of relation management is evident in the VC decision-making process (Yitshaki, 2012). VCs pay extensive consideration to the perceived parallels and interpersonal chemistry with ENs in evaluating prospective enterprises (Shepherd & Zacharakis 2001; Franke, Gruber, Harhoff & Henkel, 2006; Murnieks, Haynie, Wiltbank & Harting, 2011). Enterprise attractiveness has been shown to be biased by interactions between VCs and ENs with VC assessed enterprise attractiveness being influenced by perceived cognitive similarities (Murnieks, Haynie, Wiltbank & Harting, 2011; Neergaard & Uihøi, 2006). VCs gain confidence in the predictability of the EN's future actions using insights from this relational continuity to assess if relationship risk has been sufficiently reduced to prompt investment and the level of formal control they will require (Maxwell & Lévesque, 2011).

However, to obtain relational continuity requires repeated relational norms or cognitive similarities (Yitshaki, 2012). Where low relational norms over time are negatively associated with relational continuity (Murnieks, Haynie, Wiltbank & Harting, 2011). Setting out expectations in regards intentions and behaviours required for commitment and reciprocity, relational norms are developed over time as the result of obligatory and reciprocal behaviours between VCs and ENs (McEvily, Perrone & Zaheer, 2003; Welter & Smallbone, 2006; Ring & Van de Ven, 1994). Interpersonal obligations reduce transaction costs and the need for formal monitoring (Wang, Zhou & An, 2017). Relational norms between VCs and entrepreneurs may decrease opportunistic behaviour and therefore the need of formal control (Joshi & Arnold, 1997). However, both VCs and ENs will still have conflict considerations that may undermine cooperation (Busenitz, Moesel, Fiet & Barney, 1997; Harrison, Dibben & Mason, 1997; Yitshaki 2008; Zacharakis, Erikson, and George 2010). Indicating that relations between VCs and ENs can be best managed on informal relational norms in combination with formal control mechanisms (Shepherd & Zacharakis, 2001).

Relational norms are influenced by VCs' actual involvement (Yitshaki, 2012). Therefore, it is important to understand what types of control are executed by VCs in adding value (Lin, Chen, Lin, 2017). The level to which VCs are involved within the enterprises are identified by three distinct behavioural groups (MacMillan, Khoylian, & Kulow, 1988). Laissez faire VCs, who exhibit less involvement relative to their peers (MacMillan, Khoylian, & Kulow, 1988). Moderate VCs, who exhibit moderate levels of involvement

and close trackers, who consistently and systematically exhibit involvement in almost every activity of the enterprise (MacMillan, Khoylian, & Kulow, 1988). The effect on performance varies on the level and type of involvement (Yitshaki, 2012). VCs are also classified into a typology of strategic, supportive and networking roles where the most important value-added is delivered through a combination of strategic advisory and supportive mentor roles (Sapienza, Manigart & Vermeir, 1996). The effect of these influences is however mediated by variables such as the EN experience, the investment life cycle, geographical distance between the VC and EN, and the level innovation sought by the enterprise (Sapienza, Manigart & Vermeir, 1996). The optimal balance between formal control and relation norms should be aligned with strategic rather than managerial involvement (Yitshaki, 2012). Although it has been found that strategic involvement by VCs mediates positive relations between relational norms and EN's confidence in their VC's cooperation, managerial involvement by VCs mediates the negative relations between relational norms and an EN's confidence in their VC's cooperation (Yitshaki, 2012).

For VCs to significantly interfere in the enterprises in which they invest requires formal control rights (Cestone, 2014). However, when formal control rights are granted to the VC, the VC is induced into excessive interference which destroys entrepreneurial enterprise (Cestone, 2014). The problem is that to mitigate incentive challenges can often necessitate complicated contracts whose implications are very difficult to decipher (Bengtsson & Bernhardt, 2014a). However, the requirement for elaborate formal control mechanisms may increase agency costs of VC-supported enterprises (Tan, Zhang & Xia, 2008). Contemplating contingencies, designing contractual covenants, and seeing through their implications is costly (Bengtsson & Bernhardt, 2014b). High levels of formal control can also constrain relational continuity. Emphasising the importance of flexibility and signifying that formal control should be applied frugally to retain effectiveness (Fried & Hisrich 1994; Hatherly, 1994; Sweeting, 1991). As VCs can provide support and advice even when the EN controls the firm suggests that there is an optimal level of control that will enable trust in the relationship to develop and thereby produce the greatest level of confidence in cooperation between VCs and ENs (Cestone, 2014; Shepherd & Zacharakis, 2001). High levels of formal control can be viewed as a signalling by a VC that they see the EN as untrustworthy, which might erode any perceived trust that exists between the parties and lead to the building distrust (Shepherd & Zacharakis, 2001; Haas and Deseran 1981).

Logically, optimality lies somewhere between either of the maximum and minimum formal control spectrum where an optimum level affords and encourages trust in the relationship (Shepherd & Zacharakis, 2001). Optimal exertion of control needs to bundle together a combination of individual elements to maximise impact on enterprise performance. While optimal allocations are argued to be achieved through the combination of governance mechanisms and incentives (Tyge Payne, Davis, Moore, & Bell, 2009). The optimal exertion of control is therefore a balance between trust building mechanisms based on relational norms and the level of formal control necessary to achieve the maximum level of confidence in partner cooperation. Intuitively, the appropriate allocation and exertion of control should induce VC support while restricting VC interference (Cestone, 2014; Hellmann & Puri, 2002; Kaplan & Strömberg, 2004; Cumming & Johan, 2007).

2.4 Moderating factors influencing the optimal level of control

It is important to understand the role of various moderating factors in determining the levels of control in VC-supported enterprises (Wang, Zhou & An, 2017). As it is from this understanding can suggestions be put forward in achieving more optimal cooperative outcomes. This section reviews academic literature on the moderating factors that influence different levels of control in venture. From this review, a proposition is put forward in regarding what the findings are likely to be in exploring the moderating factors that influence the optimal level of control.

A configuration perspective is a useful lens through which to explore the moderating factors considered to influence the level of control (Drover, Wood & Payne, 2014). VCs are populated by a progressively assorted range of shapes and sizes each with varying strategic approaches, objectives, expectations and risk tolerances. (Croce, D'Adda & Ughetto, 2015). The stringency and structure of control mechanisms are not standardised among VCs, taking on different configurations dependent on each transaction's unique conditions (Drover, Wood & Payne, 2014). ENs are also considered highly differentiated, as a result each transaction has its own idiosyncratic incentive issues to address (Bengtsson & Bernhardt, 2014a). Accordingly, these vast EN variances further drive differences in the allocation and exertion of control by VCs. Ultimately determined by the venture capitalist. The level of control required by VCs is predominantly moderated by the VC's relative bargaining power, the VC's perceived level of trust and confidence in the EN, and the VC's preferred approach (Wang, Zhou & An, 2017; Payne, Davis, Moore & Bell, 2009; Drover, Wood & Payne, 2014).

2.4.1 The VC's relative bargaining power

Prominent in optimal contracting theory, the relative bargaining power of the VC is considered an influential moderating factor in determining the varying levels of control in venture capital transactions (Heughebaert & Manigart, 2012). Regardless of the approach, literature discussing optimal allocations through contracting share the assumption that one party has absolute bargaining power in reaching optimal equilibrium allocation outcomes (Koskinen, Rebello & Wang, 2014). Following this approach optimality is achieved in concluding contractual agreements based on equilibrium allocation outcomes determined by bargaining power of the parties involved. As this is determined through a negotiation process. Relative VC bargaining power is affected by the VC's individual characteristics such as reputation, size and track record, industry characteristics such as availability of capital, market sentiment and alternatives, and the EN's individual characteristics such as the EN's prestige based on knowledge, skills, and abilities (Cumming & Dai, 2011; Hsu, 2004; Meuleman, Wright, Manigart & Lockett, 2009; Drover, Wood & Payne, 2014; Heughebaert & Manigart, 2012; Hochberg, Ljungqvist & Lu, 2010).

While VCs compete for the most attractive entrepreneurial enterprises, ENs compete for critical capital and value-added benefits from the most appropriate VCs to which they have access to (Heughebaert & Manigart, 2012; Sorensen, 2007). The most reputable VCs have access to the most attractive entrepreneurial enterprises as ENs naturally favour to partner with them (Sorensen, 2007). Bargaining power affects both the appraisal of the enterprise's attractiveness and the configuration of control rights (Heughebaert & Manigart, 2012). In exchange for a reduced equity stake with a greater anticipated value creation in the future, ENs are willing to accept a lower valuation (Fairchild, 2004; Hsu, 2004; Cumming & Dai, 2011). As a result, highly reputable VCs are more likely to have their offers accepted at valuation discounts of 10 to 14% (Hsu, 2004). Naturally in a competitive exchange transaction when bargaining power is unbalanced, the party with the relative power will wield this over the other party to obtain an advantage (Heughebaert & Manigart, 2012; Cable and Shane, 1997; and Chahine and Goergen, 2011).

When the VC has an absolute bargaining power advantage, the VC is able minimise the ENs claim to the enterprise's profits by granting the VC rights or convertible claims that can be exchanged for an increased share of ownership (Koskinen, Rebello & Wang,

2014). Conversely when the EN has an absolute bargaining power advantage, the ENs can maximise their claims to the enterprise's profits by negotiating claims resembling leveraged equity and the VC a claim resembling debt security which can be converted into a relatively modest equity stake (Koskinen, Rebello & Wang, 2014). As ENs can leverage private information to increase their share, VCs are strongly incentivised to discount enterprise projections to counter this (Koskinen, Rebello & Wang, 2014). The influence of bargaining power in the VC-EN relationship also impacts how each party experiences conflict outcomes (Khanin & Turel, 2015; Molm, Collett, & Schaefer, 2006). The party with the relative bargaining power disadvantage is more likely to experience conflict more strongly than the party with the relative bargaining power advantage (Khanin & Turel, 2015).

2.4.2 The VC's perceived level of trust and confidence in cooperation with the EN

The level of control sought by the VC is linked to the VC's confidence and trust in the EN (Maxwell & Lévesque, 2011; Duffner, Schmid & Zimmermann, 2009). While confidence in how the EN will behave in the future is founded on evidence based criteria and observations such as past performance, past behaviours and formal control mechanisms (Maxwell & Lévesque, 2011; Duffner, Schmid & Zimmermann, 2009). Research on trust in the entrepreneurial context is still developing (Drover, Wood, & Fassin, 2014). Trust is determined by a configuration of behaviour dimensions such as openness, accuracy, receptiveness, reliance, consistency, benevolence, alignment, competence, judgment, experience and disclosure (Maxwell & Lévesque, 2011; Duffner, Schmid & Zimmermann, 2009).

A VC's assessment of their perceived level of trust and confidence in EN directly impacts the selection and stringency of the control mechanisms implemented (Shepherd & Zacharakis, 2001). If there is an attractive enterprise opportunity, the level of control required by VCs may serve as a substitute for entrepreneur prestige to counteract the absence of experience and affiliations (Drover, Wood & Payne, 2014). Interchangeably, there is a willingness to forgo increased levels of control if a highly prestigious entrepreneur is driving the venture (Drover, Wood & Payne, 2014). Due to the long-term nature of the relationship, trust and confidence will change dynamically over time because of external environmental changes, VC involvement and interpersonal conflict (Yitshaki, 2012). How cultures differ in moderating elements of trust and control in the VC-EN relationship is highly valuable. Differences in different cultures can be useful in influencing perceptions such that on the optimal combinations of trust and control.

2.4.3 The VC's preferred approach

Ultimately, it is argued the varying levels of control in these transactions are linked to individual VC perceptions of risk and their own preferences (Tan, Zhang & Xia, 2008). Not materially related to the nature of the entrepreneurial enterprise, varying levels of involvement is the choice exercised by VCs regarding the universal approach they wish to implement (MacMillan, Kulow, & Khoyllian, 1989). Many factors affect the level of involvement and control sought by VCs (Tan, Zhang & Xia, 2008). These include how much funding is required, the entrepreneurial enterprise's investment stage, the level of technological innovation, the level of alignment and congruence between VC and EN goals, the monitoring costs involved, the quantity of active investments in the VC's investment portfolio, the VC's industry focus, the VC's location focus and its fixed effects, the VC's organisation type and its fixed effects, the preferred management style of the VC, and level of previous experience and knowledge of the ENs and VCs (Wang, Zhou & An, 2017; MacMillan, Kulow, & Khoyllian, 1989; Sapienza & Gupta, 1994; Payne, Davis, Moore & Bell, 2009; Bengtsson & Bernhardt, 2014a; Drover, Wood & Payne, 2014). For example, VCs may focus primarily in a geographic area, development stage, or industry in which less downside protection is less typical (Kaplan and Stromberg, 2003; Bengtsson & Ravid, 2011).

VCs tend to specialise along shared characteristics such as geographic location, industry or development stage to build familiarity with the entrepreneurial enterprises in which they invest (Bengtsson & Bernhardt, 2014a). EN enterprises are highly differentiated, as a result each transaction has its own idiosyncratic incentive issues to address (Bengtsson & Bernhardt, 2014a). In turn, this vast variation drives vast variation in contracting approaches (Kaplan & Stromberg, 2003). Collectively, VCs utilise multiple distinct combinations of approaches each implying a unique allocation outcome with the ENs invested in (Bengtsson & Bernhardt, 2014a). Facing costs from experimenting with unfamiliar contract terms, VCs select from a limited set of familiar contract combinations rather than from a broader universe of all possible combinations (Bengtsson & Bernhardt, 2014a). Concentrating on a constrained set of combinations for a given investment opportunity. Repetition results in the VC making improved funding and monitoring decisions (Bengtsson & Bernhardt, 2014a). As the VC becomes more knowledgeable about the payoff, incentive and action consequences, VCs adjust what their own optimal approach should be as circumstances evolve (Bengtsson & Bernhardt, 2014a). Importantly, VCs do not use a one size fits all approach (Bengtsson & Bernhardt, 2014a).

Utilising approaches and solutions which are familiar, VCs tailor their approaches to alleviate issues specific to each investment (Bengtsson & Bernhardt, 2014a).

Using their better selection and monitoring capabilities, more experienced VCs implement far fewer contingent contractual causes in protecting performance against downside risk as contractual and noncontractual approaches are substitutes (Bengtsson & Sensoy, 2011; Burchardt, Hommel, Kamuriwo, & Billiteri, 2016; Bengtsson, 2011; Bengtsson & Sensoy, 2014a). Instead concentrating on obtaining contractual concessions such as more far-reaching board representation rights (Bengtsson & Sensoy, 2011). Experience is also positively related to the use of preferred equity instead of common equity (Kaplan, Martel & Strömberg, 2007). As with increased investor sophistication, ENs readily grant more favourable deal terms in exchange for the affiliation with more reputed VCs (Kaplan, Martel & Strömberg, 2007; Hsu, 2004).

2.5 Suggestions to achieve more optimal cooperative outcomes

Significant experience differences are characteristically found between ENs and VCs. VCs are typically seasoned and sophisticated investors who will exercise their financial and negotiation prowess disproportionately (Khanin & Turel, 2015). Due to the bargaining power held, VCs can act unethically or opportunistically (Broughman, 2010; Collewart & Fassin, 2013). While inexperience disadvantages often make ENs defensive, suspicious, and unreasonable in their dealings with financially sophisticated VCs (Tyge Payne, Davis, Moore, & Bell, 2009). None of which is conducive to achieving more optimal outcomes. Logically, ENs have limited influence in changing the VC's relative bargaining power or the VC's applied approach. Conversely, VCs have limited influence in changing the EN's relative bargaining power. As a result, suggestions to achieve more optimal cooperative outcomes should focus on the mitigation of the VCs incentive to exploit his private information to seize a greater share of the enterprise's rights than that could be extracted based on the VC's bargaining power alone by improving trust and confidence in cooperation between the VC and EN (Koskinen, Rebello & Wang, 2014). This section reviews academic literature on improving trust and confidence in cooperation. From this review, a proposition is put forward regarding what the findings are likely to be in exploring what suggestions could achieve more optimal outcomes.

2.5.1 Improving trust and confidence in cooperation

The development of trust between VCs and ENs acts to mitigate uncertainty regarding withheld information and subsequent behaviours resulting from incomplete contracts (Bruton, Fried, & Hisrich, 2000; Arthurs & Busenitz, 2003). Thus, both the EN and the VC have strong incentives to engage in trust building actions and sharing of information during the negotiation process (Maxwell & Lévesque, 2011). The relations between VCs and ENs are dependent on their motivation for cooperation (Sahlman, 1990; Sapienza & Korsgaard, 1996; Cable & Shane, 1997). Although cooperation between VCs and ENs is collectively optimal, when either party is unaware of the other's strategy their approach is to renege (Komorita, Hitty & Parks, 1991). Critical to the success of entrepreneurial enterprises are the exchanges between ENs and VCs that facilitate a thorough understanding of each other's values, perspectives, and objectives (Collewaert, 2012). Enterprise success is positively linked to the degree which ENs and VCs agree upon shared values and objectives (Bruton, Fried & Hisrich, 2000; De Clercq & Sapienza, 2006). A prominent factor in fostering the level of trust between VCs and ENs is the degree of openness between them (Kollmann, Kuckertz & Middelberg, 2014).

From social exchange and procedural justice theories, crucial to building trust in the VC-EN relationship is recurrent and open communication between the VC and the EN (Shepherd & Zacharakis, 2001). VCs frequently weigh potential agency and monitoring costs in evaluating and re-evaluating entrepreneurial enterprises (Tan, Zhang & Xia, 2008). ENs have direct access to vital private information that the VC requires to better comprehend what is happening in the enterprise (Khanin & Turel, 2015). Whenever ENs deliberately underreport, withhold information or obstruct directives crucial to equitable contract negotiation such conduct increases agency costs aggravating conflict (Sapienza & Korsgaard, 1996; Tan, Zhang & Xia, 2008). When ENs fail to meet expectations regarding their contractual obligations, VCs are likely to either replace them or take control of the enterprise (Bruton, Fried & Hisrich, 2000). The ability to develop trust in their relationships highlights a competitive advantage to be enjoyed by ENs who can develop such relational contracts with VCs (Maxwell & Lévesque, 2011). To avert conflict escalation, ENs could profit from acting proactively and cooperatively in opening communication to improve their relationships with VCs (Khanin & Turel, 2015). The exchange of private information that is new to the other party during the negotiation process and throughout the course of relationship is therefore critical in making mutually beneficial outcomes possible (Brams & Taylor, 1999). Revealing new private information reduces agency risks for both parties providing an opportunity for trust-building behaviour

for both the EN and the VC which will substitute for asymmetric or unavailable information (Maxwell & Lévesque, 2011; Kelly & Hay 2003).

From the EN's perspective, willingly revealing new private information and other trust building actions reduces monitoring costs and the risk premium which could be applied by the VC thus moderating VC's concern regarding formal control (Douglas, Carlsson-Wall & Hjelstrom, 2014; Wang, Zhou & An, 2017). Therefore, it is suggested researchers pay closer attention to connection between specific entrepreneurial behaviours and interaction outcomes (Maxwell & Lévesque, 2011). Resistance to control will likely have an adverse impact on their ability to secure funding (Drover, Wood & Payne, 2014). The observed trade-off between entrepreneurial prestige and level of control indicates entrepreneurs should consider their willingness to accept measures of control (Drover, Wood & Payne, 2014). A positive relationship between the level of control and a venture capitalist's willingness to invest is clear (Drover, Wood & Payne, 2014). This suggests investment decisions could hinge on the degree to which venture capitalists believe entrepreneurs are agreeable to several control measures (Drover, Wood & Payne, 2014). As a result, those more tolerant of control may do well to convey that to venture capitalists. By giving up control regarding private information, paradoxically means ENs regain greater overall control of their own enterprises (Sapienza & Korsgaard, 1996).

From the VC's perspective, revealing new information and other trust building actions, the VC could gain the EN's trust that the support they will provide to the enterprise could result in a larger pie and thus a smaller stake of that larger pie will represent enhanced returns for the EN despite a smaller equity stake and decision-making control (Douglas, Carlsson-Wall & Hjelstrom, 2014). However, it is implausible that ENs completely understand the implications of negotiated contracted terms (Bengtsson & Bernhardt, 2014b). It follows that VCs should internalise the possibility that ENs may misprice the downside protection mechanisms they require (Bengtsson & Bernhardt, 2014b). Through repetition of negotiations and observations of their outcomes, VCs develop deep understandings about contingencies (Bengtsson & Bernhardt, 2014b). Although not always required to alleviate the relevant moral hazard, downside protection mechanisms can be unnecessarily included in contract offers (Bengtsson & Bernhardt, 2014b). Conversely compulsory contingencies may be lead to the rejection by ENs of contracts in both parties' interest to accept (Bengtsson & Bernhardt, 2014b). Although the opportunity cost of rejection of a high potential enterprise results in VCs including fewer mechanisms for promising enterprises (Bengtsson & Bernhardt, 2014b). ENs will reject attractive offers made by VCs, even when VCs were in the belief that there were positive

profits for both parties (Bengtsson & Bernhardt, 2014b). Credibly, recommending legal counsel with expertise in VC contracting to entrepreneurs can discourage VCs from trying to extract rents via unnecessary contingencies (Bengtsson & Bernhardt, 2014b). As counsels who have observed the evolution and renegotiation of contracts, can convey this knowledge to the EN (Bengtsson & Bernhardt, 2014b).

Benevolence and integrity have the greatest impact on trust during the post-investment period (Middelhoff, Mauer, Brettel, 2014). Strengthened through regular interactions, VCs should strive to develop mentorship relationships through transparency about their principles to display integrity (Middelhoff, Mauer, Brettel, 2014). Although both ENs and VCs have stakes in the enterprise, the VC is commonly the more powerful party (Busenitz, Fiet, and Moesel 2004; Cable and Shane 1997). Enterprise success is dependent on the EN's perceptions of fairness in their relationships with VCs (Sapienza & Korsgaard 1996; Busenitz, Fiet, & Moesel, 2004). Naturally individuals care deeply about being treated with respect (Tyler & Lind, 1992). Therefore, the ENs perception of how they are treated is crucial for the success of the VC-EN relationship (Middelhoff, Mauer, Brettel, 2014). Procedural justice in the VC-EN relationship is positively linked with enhanced trust and commitment to decisions as well as cooperative behaviour (Brettel, Mauer & Appelhoff, 2013; Sapienza & Korsgaard, 1996; Brockner, 2002; Kim & Mauborgne, 1993; Moorman, 1991). When the VC-EN relationship is characterised by honesty and fairness, the prospect of reaching more favourable outcomes for task-related conflict increases as ENs are more likely to feel that their input is appreciated and considered and that they have influence over decisions (Sapienza, Korsgaard, Goulet & Hoogendam, 2000; Korsgaard, Schweiger & Sapienza, 1995; Sapienza & Korsgaard, 1996). Independent director arbitration could be a solution to achieve more optimal cooperative outcomes as under independent director arbitration neither the VC nor the EB is able to unilaterally threaten to pursue their preferred action. Instead proposed actions would need to be endorsed by the independent director where convergence to the independent director's preference can reduce conflict by moderate each party's actual threats. Which in turn may expand the range of entrepreneurial enterprises which receive venture capital investment (Broughman, 2013).

2.5 Chapter summary

Having presented an introduction into the research problem by providing background on the research problem, what the research objectives are, and the motivations for the research in the previous chapter. This chapter presented the argument of the research

with reference to relevant venture capital literature. From this review propositions are put forward regarding what the findings are likely to be in exploring the research objectives. As types of venture capital firms are broken down into two types of firms each with different sub-categories, in reviewing the types of venture capital firms, this section discussed captive and independent firms and their various sub-categories. As VCs gain and exert control through formal and informal control mechanisms, in reviewing what the optimal level of control is, this section discussed what control is, how control is allocated, and how control is exerted. As the optimal level of control is ultimately determined by the VC, in reviewing what moderating factors are influencing the optimum level of control, this section discussed the VC's relative bargaining power, the VC's perceived level of trust and confidence in cooperation with the EN, and the VC's preferred approach. As ENs have limited influence in changing the VC's relative bargaining power or the VC's applied approach, in reviewing what suggestions could achieve more optimal cooperative outcomes, this section reviewed improving trust and confidence in cooperation between VCs and ENs. The next chapter presents the propositions put forward regarding what the findings are likely to be in exploring the research objectives.

Chapter 3: Propositions

3.1 Chapter outline

To gain an understanding into the optimal level of control in venture capital to enable the attainment of more optimal cooperative outcomes. This multiple case study research aims to explore what the optimal level of control is, explore what moderating factors influence this optimum level, and explore what suggestions could achieve more optimal cooperative outcomes. By investigating optimality through a cooperative rather than a competitive exchange perspective to provide insights into how and why different allocation arrangements and exertion methods are applied across three cases of South African VCs operating different types of seed, start-up, growth, and development stage venture capital firms. The three types of venture capital firms presented in the cases for this study were an an independent Section 12J Venture Capital Company, a corporate captive, and an independent investment entity. Having presented the argument of the research with reference to venture capital literature in the previous chapter. This next chapter presents the propositions put forward regarding what the findings are likely to be in exploring the research objectives.

3.2 The optimal level of control

As VCs gain and exert control through formal and informal control mechanisms. In exploring what is the optimal level of control, the following proposition is put forward regarding what the findings are likely to be.

Proposition 1: *The optimal level of control should satisfy the venture capitalist's financing constraint by enabling the venture capitalist to monitor and direct entrepreneur behaviour to ensure invested capital is used appropriately, while maximising the entrepreneur's incentives by being more relational than formal, more supportive than interfering, and more strategic than managerial*

3.3 Moderating factors influencing the optimum level of control

As the optimal level of control is ultimately determined by the VC. In exploring what moderating factors are influencing the optimum level of control, the following proposition is put forward regarding what the findings are likely to be.

Proposition 2: *The optimal level of control is a function of the venture capitalist's relative bargaining power, the venture capitalist's perceived level of trust and confidence in cooperation with the entrepreneur, and the venture capitalist's preferred approach, where the venture capitalist's preferences in conjunction with their own perceptions have the greatest influence*

3.4 Suggestions to achieve more optimal outcomes

As ENs have limited influence in changing the VC's relative bargaining power or the VC's applied approach. In exploring what suggestions could achieve more optimal cooperative outcomes, the following proposition is put forward regarding what the findings are likely to be.

Proposition 3: *To achieve more optimal cooperative outcomes, venture capitalists and entrepreneurs should improve trust and confidence in cooperation by revealing private information new to the other and encouraging procedural justice by treating the other honestly and fairly*

3.5 Chapter summary

Having presented the argument of the research with reference to venture capital literature in the previous chapter. This chapter presented the propositions put forward regarding what the findings are likely to be in exploring the research objectives. The next chapter presents the details and defence of the research design and methodology.

Chapter 4: Research design and methodology

4.1 Chapter outline

To gain an understanding into the optimal level of control in venture capital to enable the attainment of more optimal cooperative outcomes. This multiple case study research aims to explore what the optimal level of control is, explore what moderating factors influence this optimum level, and explore what suggestions could achieve more optimal cooperative outcomes. By investigating optimality through a cooperative rather than a competitive exchange perspective to provide insights into how and why different allocation arrangements and exertion methods are applied across three cases of South African VCs operating different types of seed, start-up, growth, and development stage venture capital firms. The three types of venture capital firms presented in the cases for this study were an an independent Section 12J Venture Capital Company, a corporate captive, and an independent investment entity. Having presented the propositions put forward regarding what the findings are likely to be in exploring the research objectives in the previous chapter. This chapter presents the details and defence of the research design and methodology. This chapter discusses the:

- Choice of methodology
- Unit of analysis
- Population
- Sampling method and sample size
- Research instrument
- Data gathering process
- Analysis approach, and
- Limitations

4.2 Choice of methodology

As this research was not dependent on numerical measurements. To enable the unearthing of novel perspectives and provision of intricate interpretations through a perspective where limited empirical research has been conducted, a mono method qualitative strategy was used (Saunders & Lewis, 2012; Zikmund, Babin, Carr & Griffin, 2013). The approach followed exploratory, descriptive and explanatory research design. The research design incorporated exploratory elements as the research problem was uncertain and required further exploration (Saunders & Lewis, 2012). Descriptive

elements as the research described current venture financial intermediation practices in how control is allocated and exerted (Saunders & Lewis, 2012). As well as explanatory elements as the research aimed to identify and explain casual relationships between moderating variables (Saunders & Lewis, 2012; Yin, 2009). As a result, this research incorporated both inductive and deductive approaches.

Confidentially challenges and time constraints make the analysis of the venture capital investment transactions inherently difficult. To address these difficulties a case study approach was undertaken. More manageable, particularly in circumstances with constrained resources and time horizons, the case study approach was used for a variety of reasons (Yin, 2009). Case studies are particularly beneficial in the initial stages of research, especially when little is known about the phenomenon and there are various viewpoints (Saunders & Lewis, 2012; Leedy & Ormond, 2010). Involving the intensive study of a single unit or multiple units for understanding a greater class of similar units, case studies provided the researcher with the opportunity to obtain an in depth and holistic perspective of the research problem (Gerring, 2004; Baxter & Jack, 2008; Eisenhardt & Graebner, 2007). Allowing for depiction of complexity for further research, cases studies enabled the researcher to gain information rich data drawn from actual experiences which could be linked to action (Yin, 2009; Saunders & Lewis, 2012).

Described as a preferential method of research for asking *how* and *why* questions for the study of contemporary phenomenon within a real-world context where the researcher has limited influence over events (Yin, 2009; Jones, McFonnell & Read, 2000). Case studies gave the researcher versatility by allowing the researcher to address exploratory, descriptive and explanatory types of research questions (Yin, 2009). To unearth more rich and diverse sets of perspectives, a multiple case research design was used across the sample population so that each case selected either predicted similar results or predicted contrasting results but for anticipatable reasons (Yin, 2009). Particularly beneficial in the context of inductive research, multiple case studies were used as multiple cases typically result in more vigorous, generalised and applicable findings than single case designs because propositions are more deeply based in diverse evidence (Eisenhardt & Graebner, 2007; Yin, 2009).

4.3 Unit of analysis

The final unit of analysis for this research was the retrospective discernments, attitudes, opinions, and perceptions of the sampled South African VCs operating different types of seed, start-up, growth, and development stage venture capital firms.

4.4 Population

For this research, the VC population selected was defined as South African VCs operating different types of seed, start-up, growth, and development stage venture capital firms. The three types of venture capital firms presented in the cases for this study were an an independent Section 12J Venture Capital Company, a corporate captive, and an independent investment entity.

4.6 Sampling method and sampling size

Following a distinctive five step process of case selection, preliminary investigation, data collection, data analysis, and case reporting (Baškarada, 2014). The sampling method and sampling size specifically deals with the case selection and preliminary investigations steps of the case study process. As no complete sampling frame was available for the selection of South African VCs operating seed, start-up, growth, and development stage venture capital firms, non-probability sampling techniques were used by the researcher (Saunders & Lewis, 2012). For this research, purposive and convenient sampling methods were used. Being a qualitative research undertaking there was no need for numeric representation to make statistical inferences about the characteristics of the population (Baškarada, 2014). Sampling in qualitative research using the case study method necessitates information rich data nested within their specific context and analysed extensively (Miles & Huberman, 1994; Baškarada, 2014). As a result, a small sample size was sufficient in exploring the research propositions (Creswell, 2014).

A replication approach by which researchers can generalise from one case to another based on agreement with underlying theory (Baškarada, 2014). It is acknowledged that there is no ideal number of cases (Darke, Shanks & Broadbent, 1998; Perry, 1998). The selection of cases is not made based on representation (Baškarada, 2014). Depth within a specific case or breadth across multiple cases should take precedence dependent on the nature of the research problem, research timeframe, obtainable resources and case

availability (Darke, Shanks & Broadbent, 1998; Perry, 1998). The greatest challenge with the case study method is gaining access to suitable case study entities (Walsham, 2006). It has therefore been argued by some that it may be more practical to fit any theoretical contribution based on case study accessibility (Pan & Tan, 2011).

To obtain a quality sample set to assist in understanding the discernments, attitudes, opinions, and perceptions of South African VCs operating different types of seed, start-up, growth, and development stage venture capital firms. A purposive sampling approach was first applied in specifically selecting a suitable small sample. Cases were selected purposively based on certain features considered to be of interest to maximise the differences in comparative groups (Seawright & Gerring, 2005; Silverman, 2005; Patton, 2002). These certain features included the firm's type, location of focus, and investment stage. As a purposive approach was applied, the researcher's judgement was used in identifying and selecting interviewees who would best assist in exploring the research propositions (Saunders & Lewis, 2012). A heterogenous approach was undertaken by the researcher to ensure that the sample selected had sufficient diverse characteristics to afford adequate variation in the data that was gathered (Saunders & Lewis, 2012).

Using the SAVCA 2017 Members Directory, the SARS Approved List of Section 12J VCCs and other resources such as the researcher's personal networks and online searches. Relevant potential cases across were identified in accordance with experience and prominence. Judgment had to be used as the information contained in the SAVCA Members directory was often inaccurate and included an assortment of Private Equity funds targeted at different investment stages. Judgment also had to be used in the selection of Section 12J VCCs as it was found that these funds were more broadly focused on equity investments in small and medium sized enterprises operating at varying stages of the investment lifecycle rather than on seed, start-up, growth and development stages. The VCs selected to participate were approached to take part via various cold approaches including emailing, calling, and visits in conjunction with formal introductions where available. With a response success rate of less than 20 percent. Convenient sampling was used as finding willing participants proved very difficult given the considerable confidentiality challenges, extreme unwillingness, and significant timing constraints of VCs. Ultimately, access to and willingness of the respondent VCs determined which of them were selected and presented for this research. The following cases of South African VCs operating venture capital firms were used for this research.

Table1: Case 1

Venture Capital Firm 1 [VCF1]	
Type & structure	Independent firm – Section 12J VCC
Investment stage	Seed; start-up; growth
Location of focus	South Africa
Venture Capitalist Respondent 1 [VCR1]	
Position	Founder & General Partner
Industry experience	3
Background	Chartered Accountant

Table 2: Case 2

Venture Capital Firm 2 [VCF2]	
Type & Structure	Captive corporate firm – on balance sheet
Investment Stage	Start-up; growth; development
Location of focus	Global
Venture Capitalist Respondent 2 [VCR2]	
Position	Principal Market Development
Industry experience	4
Background	Mining & Consulting

Table 2: Case 3

Venture Capital Firm 3 [VCF3]	
Type & Structure	Independent firm - Investment holding entity
Investment Stage	Development
Location of focus	Sub-Saharan Africa
Venture Capitalist Respondent 3 [VCR3]	
Position	Founder & Managing Director
Industry experience	5
Background	Consulting

4.7 Research instrument

To enable a deep examination into the complexity of an area relatively unexplored, semi-structured opened-ended face-to-face and telephonic in-depth interviews were used (Bryman & Bell, 2011; Saunders & Lewis, 2012).

4.8 Data gathering process

The quality of any empirical research undertaking, including the case study approach, is dependent on reliability and validity (Edmonds & Kennedy, 2012). To prove that the same results could be attained by repeating the data collection procedure (Baškarada, 2014).

The researcher applied two approaches. Firstly, the researcher established a case study protocol standardising the investigation (Baškarada, 2014). The case study protocol included the purpose of the protocol, the research instrument protocol, the data collection procedures to be followed, a basic outline of the case study report, initial high-level case study questions, and existing references (Baškarada, 2014). Secondly, the researcher established a case study database storing all pertinent documents including the case study protocol documents, audio recordings, interview transcripts, researcher notes, documentary notes, and analysis of the data collected (Baškarada, 2014).

As the research instrument used was semi-structured interviews. Appointments were appropriately scheduled and coordinated at a convenient location. To ensure open dialogue and discussion transpired on the pertinent and applicable areas of focus. As part of the case study protocol, an interview guideline was drafted in accordance with predetermined content inferred directly from the research guidelines and relevant literature (Bryman & Bell, 2011; Saunders & Lewis, 2012). To enable the possibility of cross-case analysis, the interview guideline included focused discussion guides around the firm and the respondent VCs to ensure stimulus to ensure equivalent stimulus across all cases (Hussey & Hussey, 1997).

Subjective by nature, qualitative research is affected by a variety of biases in the collection and interpretation of data (Saunders & Lewis, 2012). Results from the collected data could be affected by the person conducting the interview not being proficiently skilled or experienced in interview techniques (Agee, 2009). To provide the researcher with the chance to implement any necessary adjustments in respect to both content and procedures to be followed, three pilot tests were used to trial and review the interviewer's technique and proposed interview guideline (Bryman & Bell, 2011; Saunders & Lewis, 2012; Yin, 2009). The pilot interviews provided the researcher with the opportunity to implement lessons learned into the following iterations (Baškarada, 2014). Conducting an initial case study analysis on the pilot cases in parallel with data collection activities enabled the researcher to make amendments and alterations to the case study design as required (General Accounting Office, 1990).

To ensure the respondent VCs were dealt with in an ethical and professional manner. For each of the potential respondents approached. The researcher made full and complete disclosures regarding the purpose of the research and the anonymity and confidentiality of disclosed information, so the each participated based on informed consent (Silverman, 2005). Which the researcher reiterated at the start of each interview

conducted. With the consent of the respondent VCs, interviews were recorded and transcribed to enhance data quality. Each transcript was edited and made anonymous by the researcher through editing all identifying markers or details which might enable the VCs or their firms to be identified. This included changing the names of the firms and the names of the respondent VCs to acronyms based on the numerical order they were presented in the report.

Although it is argued that anything less than 15 interviews per case study entity is typically insufficient. The appropriate number of interviews will be dependent on the size of the unit analysis in this case venture capital fund. Typically, very small, venture capital funds consist of very small teams between of approximately five and ten members, and the respondent venture capital funds were no different. As a result, only one interview was conducted per venture capital fund with the principal decision-maker who was either the founder and managing general partner, or key investment principal. The challenge faced by the researcher was that there are many snares that can impend an effective interview (Baškarada, 2014). These include misinterpretation, interjecting with comments that can bias the response, using leading or loaded questions, or interviewee challenges such as potential bias, being unable to appropriately articulate their responses, and poor recall (Baškarada, 2014). As a result, it is important to obtain varying perspectives as failure by the researcher to explore alternative explanations can result in unjustified conclusions (Baškarada, 2014).

Limited to only one respondent VC per venture capital fund. To improve the internal validity of the research, the researcher used methodological and data source triangulation in the form of cross-case comparisons and analysis of venture capital term sheets provided from the respondent VCs (General Accounting Office, 1990). Used to validate the control allocation provisions detailed during the interview process. As EN enterprises are highly differentiated, each with their own idiosyncratic incentive issues to address (Bengtsson & Bernhardt, 2014a). Term sheets are tailored in accordance with the unique characteristics of each specific transaction. For this research, the standardised or generic term sheets used by the sampled VCs were obtained. Also varying across each case in accordance with the sampled VCs preferred approach. The term sheets provided included a combination of the following terms:

- the investors,
- total investment amount,
- milestones,

- types of shares,
- outstanding loans,
- price per share,
- valuation,
- capitalisation,
- shareholder's agreement,
- liquidation preference,
- protective provisions,
- anti-dilution provisions,
- representations and warranties,
- conditions precedent to closing,
- counsel,
- definitive agreements,
- expenses,
- information rights,
- right to participate pro rata in future rounds,
- matters requiring board approval,
- non-competition and non-solicitation agreements,
- non-disclosure and development agreements,
- board matters,
- insurance,
- right of first refusal,
- board observer,
- drag-along and tag-along,
- target date and no shop,
- expiration,
- conduct of business,
- anti-bribery and corruption,
- confidentiality,
- the governing law and jurisdiction, and
- reserved matters covering matters requiring approval from shareholders, board decisions requiring approval from shareholders and decisions to be approved by simple board majority.

To enhance the accuracy and completeness of the case study. The researcher had the interviewees review key responses and explain any responses requiring further clarity, to ensure that the essences were captured accurately, and any range of competing perspectives were not omitted (Yin, 2009; General Accounting Office, 1990). To further improve the validity of the research, the researcher established and maintained a chain of evidence by providing an audit trail which could clarify how any conclusions have been drawn by allowing reviewers to trace from questions asked to conclusions drawn or vice versa (Yin, 2009; General Accounting Office, 1990; Miles & Huberman, 1994).

4.9 Analysis approach

With the objective of extracting abstract concepts linked to theoretical foundations from each unit of analysis to potentially be applicable to other cases (Yin, 2013). An intimacy with literature and context is necessary to accurately analyse the data collected (Leedy & Ormond, 2010). Intended to provide insight into each case's real setting. The first step in the analysis process involved the researcher detailing a summary overview or summative narrative for each case. To enhance the validity and reliability (Pandit, 1996). This was constructed from various sources including the 2017 SAVCA Members Directory, company documents, online resources, transcriptions and the provided term sheets which made up each case.

The principal weapon in the qualitative analysis armoury, comparative techniques are used to discover the hidden patterns in responses from multiple respondents (Glaser, 2002; Jorgensen, 1989). The second step in the analysis process involved the researcher presenting a cross-case analysis enabled by analytic induction and deduction. This was done deliberately by researcher to mitigate challenges allied with reaching incorrect or hasty conclusions (Eisenhardt 1989; Miles and Huberman, 1994). Continuing with the organisation of data involved in preparing data displays. This process enabled the researcher to present the unique patterns of the individual cases while generalising patterns across the cases to deepen understanding and explanation (Miles & Huberman, 1994; Eisenhardt, 1989). As the data collected was qualitative in nature, content analysis was utilised to analyse and interpret the data (Leedy & Ormond, 2010). Using the theoretical propositions put forward in the above chapters, the researcher focused on the most relevant data (Yin, 2009). Using common ideas not based on frequency, themes were used by the researcher to help identify the most common concepts and conceivable differences in interpretation among the respondent VCs (Klein & Myers, 1999). The iterative process of searching for cross-case patterns based on

emerging and defined themes drawn relevant literature, enabled the researcher to explain the *why* (Eisenhardt 1989; Miles & Huberman, 1994). Where the summarising comments made by the researcher were fully supported by verbatim quotations from the transcripts.

4.10 Limitations

Numerous limitations to this research were identified:

- It is argued that the possible generalisation of the data gathered to a larger population is one of the disadvantages of the case study method (Saunders & Lewis, 2012). As detailed above, multiple case research design typically results in more vigorous, generalised and applicable findings than single case designs because propositions are more deeply based in diverse evidence (Eisenhardt & Graebner, 2007; Yin, 2009). However, as this research studied only three South African VC firms. By inference, the above the benefits are limited in these results. This has led to the under-representation of groups within the sample such as *en commandite* partnerships, other listed entities such as SPACs, and government or other captive firms. Thus, weakening the researcher's ability to infer generalisations from the sample population. However, the limited size of the sample does not preclude conclusions drawn from similarities in cases applying different investment approaches or conclusions drawn from differences in cases with similar firm structures.
- It is argued that case study analysis that applies both cross-case and within-case analysis techniques have been found to be more effective at building formal propositions and theoretical frameworks (Barratt, Choi & Li, 2011). As only a cross-case analysis technique has been employed. The interviewing of multiple VCRs for each case could contribute to the improvement of construct validity (Yin, 2009).
- As detailed above, the challenge faced by the researcher is that there are many snares that can impend an effective interview (Baškarada, 2014). These include misinterpretation, interjecting with comments that can bias the response, using leading or loaded questions, or interviewee challenges such as potential bias, being unable to appropriately articulate their responses, and poor recall (Baškarada, 2014). As only one researcher was used. It is argued that the use of different researchers through investor triangulation could further improve the internal validity of the research (Baškarada, 2014; Yin, 2009).

- Through repetition, VCs become more knowledgeable about the payoff, incentive and action consequences of the approaches and adjust what their own optimal approach should be as circumstances evolve (Bengtsson & Bernhardt, 2014a). As a result, increased experience results in the VC making improved funding and monitoring decisions (Bengtsson & Bernhardt, 2014a). As all the VCRs of the cases are relatively inexperienced in the venture capital industry. By inference has weakened the researcher's ability to infer generalisations from the sample population.
- Research that considers venture capital investment transactions from the EN's perspective is underrepresented (Drover, Wood & Fassin, 2014). With most research on informal relational control in entrepreneurial contexts neglecting the perspective of ENs (Duffner, Schmid & Zimmermann, 2009). To enhance this research, insights could have been gathered from ENs perspective by moving their perceptions into focus.

4.11 Chapter summary

Having presented the propositions put forward regarding what the findings are likely to be in exploring the research objectives in the previous chapter. This chapter presented the details and defence of the research design and methodology by discussing the choice of methodology, unit of analysis, population, sampling method and sample size, research instrument, data gathering process, analysis approach, and limitations of the research. This summarised in the table below. The next chapter presents the cases and results of cross-case findings.

Table 4: Chapter 4 Summary

Research design	Exploratory, descriptive and explanatory
Research philosophy	Interpretivism
Research approach	Inductive & deductive
Research strategy	Multiple case study
Choices	Mono method
Time frame	Cross-sectional
Population	South African VCs operating venture capital funds
Unit of analysis	The retrospective discernments, attitudes, opinions, and perceptions of the sampled South African VCs
Sample method	Purposive & convenient
Sample size	3 cases
Data collection	Semi-structured interviews
Data analysis	Cross-case inductive and deductive content analysis

Chapter 5: Results

5.1 Chapter introduction

To gain an understanding into the optimal level of control in venture capital to enable the attainment of more optimal cooperative outcomes. This multiple case study research aims to explore what the optimal level of control is, explore what moderating factors influence this optimum level, and explore what suggestions could achieve more optimal cooperative outcomes. By investigating optimality through a cooperative rather than a competitive exchange perspective to provide insights into how and why different allocation arrangements and exertion methods are applied across three cases of South African VCs operating different types of seed, start-up, growth, and development stage venture capital firms. The three types of venture capital firms presented in the cases for this study were an an independent Section 12J Venture Capital Company, a corporate captive, and an independent investment entity. Having presented the details and defence of the research design and methodology in the previous chapter. This chapter presents the cases and results of cross-case findings. This chapter discusses:

- An overview of the cases presented
- The cross-case analysis findings

5.2 Overview of the cases presented

5.2.1 Case 1

Table 5: VCF1

Inception	2016
Headquarters	KwaZulu-Natal
Type	Independent firm – Section 12J VCC
Investment stage	Seed; start-up; growth
Industry focus	Disruptive technology with focus on communication technology, healthcare, engineering & energy
Location of focus	South Africa with investments in KwaZulu-Natal & Gauteng
No. of portfolio co.'s	7

Committed capital to firm	50 million ZAR
Investment sizes	Between 1,5 million ZAR & 8 million ZAR
Unallocated capital	0
Syndication & frequency	None
Equity stake	Significant minority, 25 to 49%
Instrument	Common equity
Allocation of control - Control provisions	Standardised – Board representation; special resolutions & reserved matters; staging of capital; performance milestones; vesting shares & options; signatory on bank accounts
Exertion of control - Level, type and frequency of involvement & monitoring	Strategic & supportive; through the board; weekly & monthly portfolio contacts; internalisation of financial reporting; monthly financial accounts

Structured as an independent SARS approved Section 12J Venture Capital Company. VCF1 started raising funds from third party investors wishing to take advantage of the tax incentive advantages in June of 2016. First capitalising the fund, and then deploying the capital that had been invested. VCF1 made their first investments in September of 2016 and have invested in seven entrepreneurial enterprises to date. With no unallocated funding to date. The firm has not been closed out. Investing in entrepreneurial enterprises that are unique, scalable and can change both the present landscape and prevailing business models. VCF1 portfolio is focused on disruptive technology across the communication technology, healthcare, engineering, and energy. Predominantly invested KwaZulu-Natal where they are based. They are pursuing other opportunities identified in Gauteng. Typically takes a significant minority equity using a simple funding mix of common equity and debt with investment sizes between 1,5 million and 8 million ZAR. VCF1 focuses on seed, start-up and growth stages. Actively involved in each of their portfolio enterprises. VCF1 assists with the development of the appropriate strategic approach for growth by working with the senior management team to provide them with the tools for both personal and business development. Offering strategic guidance, VCF1's team of partners aim to add value by providing strategic input

and leverage their networks to create opportunities for future growth and the resources to attract the best talent you need right when you need it.

5.2.2 Case 2

Table 6: VCF 2

Inception	2013
Headquarters	Gauteng
Type	Captive corporate firm – on balance sheet
Investment stage	Start-up; growth; development
Industry focus	Stimulate demand for holding company's products
Location of focus	Global with investments in the US, Canada, the UK, and Germany
No. of portfolio co.'s	9
Committed capital to firm	100 million USD
Investment sizes	Between 2 million USD and 5 million USD with follow on up to 20 million USD
Unallocated capital	0 – capital held back for follow-on investments
Syndication & frequency	Yes, often
Equity stake	10 to 20%, can go up to 30% with follow on investments
Instrument	Preferred equity & convertible notes
Allocation of control - Control provisions	Standardised & tailored – Board representation; appointment of independent board directors; special resolutions & reserved matters; staging of capital; performance milestones; vesting shares & options; liquidation preferences; anti-dilution; tag along; drag along; participation; veto rights at board level; right of first refusal; non-competition & non-solicitation agreements
Exertion of control - Level, type and frequency of	Strategic & supportive through the board & weekly & monthly portfolio contacts; quarterly financial reporting

involvement & monitoring	
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Structured as a captive on-balance sheet firm of a large listed parent entity. VCR2 is exclusively managing its parent entity's capital. As a result, both the source of capital and affiliation to the parent entity are important in understanding the VCF's investment objectives and approach. Being a captive fund of a large listed mining entity. The purpose is not purely financial, but to pursue the strategic objectives critical to the health of the parent entity. Which is to stimulate demand for the group's products which are the group's platinum and associated metals. Born out of the struggles faced by platinum miners in restructuring their operations due to the prolonged continuance of stagnant prices, weak demand, and labour unrest. The hope is that investments in start-up, growth, and development stage entrepreneurial enterprises will develop technologies based on platinum and other metals such as ruthenium and iridium. Established in 2013 to drive the commercialisation of the group's metals. Capital is invested into entrepreneurial enterprises that can show the commercial viability of technologies or products that enable the use of any of the group's metals. While further enabling complementary advantages in the form of long-term pricing benefits, reliable supply, and the exploration for commercial opportunities across the group. Investing in countries such as the US, Canada, the UK, and Germany. Syndication with other financiers is common. VCF takes smaller equity positions of 10 to 20 percent, with up to 30% for follow-on using preferred equity. Among the nine entrepreneurial enterprises currently invested in, these include hydrogen fuel cell producers, battery makers and gas-to-liquid technology with investment sizes ranging between two million USD and five million USD. With follow on up to 20 million USD. Further investments are expected to be made in electronics, medical devices, and water treatment. Having raised 10 million USD initially, the firm has received another 100 million USD and is working on 100 million USD tranche. All capital has been allocated with a certain amount held back for follow-on investments. There is an intention bring other investors on board and to spin-out to become an off-balance sheet investor.

5.2.3 Case 3

Table 7: VCF3

Inception	2013
Headquarters	Western Cape
Type	Independent – investment holding entity
Investment stage	Incubation; growth; development (predominantly development)
Industry focus	Technology & internet focused with investments in E-commerce; digital services; travel; online classifieds
Location of focus	Sub-Saharan Africa – Mostly South Africa
No. of portfolio co.'s	13
Committed capital to firm	200 million ZAR
Investment sizes	Between 2 million ZAR and 13 million ZAR depending on follow-on
Unallocated capital	0 – capital held back for follow-on investments
Syndication & frequency	Rarely
Equity stake	Minority & majority holdings (predominantly majority)
Instrument	Preferred and common equity (predominantly preferred)
Allocation of control - Control provisions	Standardised & tailored – Board representation; staging of capital; vesting shares & options; liquidation preferences; tag along; drag along; pre-emptive rights; right of first refusal; reserved matters (minority holdings)
Exertion of control - Level, type and frequency of involvement & monitoring	Strategic & supportive through the board & weekly & monthly portfolio contacts; monthly financial reporting

Structured as an independent investment holding entity. VCF3 invests on-balance sheet, from capital raised from third-party investors who hold shares in the VCF itself. VCF3

raises capital as when required with currently with 200 million ZAR committed. In the belief Africa will be world's growth frontier with a large under-served market, low internet penetration, rapidly growing consumer class, and massive potential for catch-up in comparison to the developed world. VCF3 invests in growth and development stage technology and internet based entrepreneurial enterprises targeting Sub-Saharan African markets and South African markets. In addition to this, VCF3 also incubates and invests into entrepreneurial enterprises. However heavily favouring post-revenue development stage enterprises. Currently VCF3 has 13 portfolio enterprises with investment sizes ranging from two million to 13 million ZAR including follow-on. Predominantly taking majority equity positions using preferred equity. VCF3 aims to add value through improving operational excellence and capital efficiency by providing professional management or management support, business model development, access to large-scale investors, and other support functions such as talent management, marketing, information technology and marketing.

5.3 Cross-case analysis

5.3.1 The optimal level of control

In line with the argument put forward in chapter 2. As VCs gain and exert control through formal and informal control mechanisms. In exploring what the optimal level of control is, the results of the retrospective discernments, attitudes, opinions, and perceptions of the sampled VCs operating the three venture capital firms have been presented on *how* and *why* control is allocated and *how* and *why* control is exerted.

5.3.1.1 Allocation of control

Influencing certain decisions was consistently viewed across each case as central to the protection of invested capital. Although each case had varying common, shared and distinct control provisions. Across all cases when taking minority equity positions, key was the separation of cash flow and control rights. So that regardless of the equity holding, each VCR could protect their investment by being able to formally influence decisions regarding special resolutions and restricted or reserved matters through their board representation. Set out in the term sheet provisions, the special resolutions and reserved matters cover matters requiring approval from shareholders, board decisions requiring approval from shareholders, and decisions to be approved by simple board majority. This would typically cover material decisions which could adversely affect the

invested capital such as strategic business plan and budget implementation, spending levels, asset acquisitions and disposals, external borrowings, remuneration agreements, and matters affecting the equity holding such as repurchases, redemptions, recapitalisations and issuances. Therefore, even though the VCFs would not hold the majority shareholders' voting rights when holding a minority stake. Through the contractual agreements in place, the VCRs involved in these entrepreneurial enterprises would be able to have an influence on certain special resolutions or reserved matters without having to go to a shareholders' vote on every decision. This was viewed as important, as without these provisions they would inevitably be overpowered every time. Thus, by using provisions to counteract their smaller voting rights. The VCFs separate cash flow and control rights by being able to exert disproportionate influence over certain matters than they would have able to do, if those decisions had made in accordance with the implied voting rights as per their equity holding. Effectively providing protection on material decisions which could adversely affect their investments. In the case of VCF3, when it took majority positions, the special resolutions or reserved matters were naturally not as stringent or pertinent.

VCR1: "In terms of special contracts and clauses we do have things in the MOI that we write in.... that we do put in place there."

VCR1: "Right through to spending matters on contractual value and commitments in the business."

VCR1: "We insert certain clauses, that require restricted matters and special resolutions. So, we do have a list of other restricted matters that require special resolution. To date we have always had more than 25% equity, if we had to reduce it to 20, then you know restricted matter would require you know 80.1%.... for example, so that's how we protect ourselves there."

VCR1: "It has got be a board decision, and the board the board decision through the collective process is very important."

VCR2: "You don't want to have to go back to voting.... you want to make sure that decisions are made by consensus at the board and not necessarily having to go back to shareholders. As often the founders will hold majority shares and you don't want anything going back or the time to a shareholder vote because then you will just be vetoed or taken out every time."

VCR2: “Typically veto rights sit at board level.... We have unanimous agreement at the board that seems to work better in contracts than veto.”

VCR2: “The other way is key provisions, if transaction amounts are above a certain amount.... need to make sure the companies can’t spend higher than a certain amount without having to ask the board.... that is written into the investment.”

VCR2: “If you want to employ somebody, we put in our investment agreements, for instance anyone that costs more than a certain amount, an employee. That remuneration agreement has to come to the board for approval.”

VCR3: “Where we have not got majority, we would have reserved matters.”

VCR3: “Every deal is kind of different because.... when we do initially a minority investment.... we want some reserved matters of minority protection.”

In addition to the separation of cash flow and control rights. Key in each case was the alignment of VC and EN incentives. Central to that was that was the ability to influence entrepreneur behaviour. Also set out in the term sheets provided. Common across each case was the use of vesting shares and put options to tie the investor down or lock the investor in for a prescribed period. Also, common across all cases and included in the term sheets provided was the staging of committed capital in tranches. Although very prevalent for VCF1 and VCF2 in comparison to VCF3, the release of these tranches was contingent on the fulfilment of predetermined and prescribed financial and non-financial performance milestones. Viewed as a critical mechanism by VCR1 in focusing EN behaviour and actions in terms of pacing and execution of agreed business plan implementation. As funding is only released on the achievement of these prescribed milestones. The VCRs could influence EN behaviour and actions in line with shared objectives as non-compliance would result in drying up of much need capital. In addition to aligning EN actions and behaviour, the use of staging was done so as an additional protection mechanism against potential capital loss. By allocating capital in tranches, VCFs could protect their capital investment should the relationship breakdown or the business fail. This was viewed as important by VCR2 as many of the relationships would break down very early on, usually before the prescribed milestones. Thus, the staging of capital injections provided the VCRs with the ability to mitigate against this without losing further capital. An added benefit raised by VCR2, was that the non-fulfilment of these

milestones provided an opportunity to renegotiate for more favourable contract concessions elsewhere which could not be achieved during the initial negotiations. Even though the EN may have missed the prescribed milestone requirements, VCR2 would agree to release the funding contingent on the agreement of additional clauses.

VC2: “We stage funding.”

VCR1: “On milestone payments we’ve used that as a control mechanism to keep the entrepreneur focused on goals that have been predetermined at the outset of the transaction, and that has worked with varying degrees of success. So, in the one business it was successful in that it kept the entrepreneur on target.... We don’t view putting milestones in place as a punitive measure... to say that if you don’t get it right then we have just scored ourselves a bigger deal, as we get the same deal for less money. That is not our view. We view it as helping keep things on track in terms of focus. That’s worked quite well.”

VCR2: “We always stage.”

VCR2: “The performance milestone is probably your strongest tool.”

VCR2: “This is VC, you understand that you take those risks. That is why you stage the payment.... If you don’t achieve we hold the power of having to give you the money or not.”

VCR2: “My preferred approach is to drip money in, as much as possible. So, don’t do the big tickets. Smaller tranches more often.... Some near-death misses, some near missed with big amounts.”

VCR2: “Luckily, when we have tranced out investments.... the experiences we had is that the relationship will break down pre, we have actually invested or our performance milestones.”

VCR2: “The nice thing about milestones is that it gives you the ability to renegotiate your own deal later on. If they haven’t hit the milestone, often we are willing to renegotiate, but with renegotiation comes something else. It comes with another request. I have done that recently in two transactions where they haven’t hit milestones, then the investment amount that I have given stays the same maybe.... I can renegotiate some parts of it. I

don't necessarily want to take more equity, maybe I want something else. I want you to allocate money to a specific cause.”

VCR3: “We tranche capital.... but it's not typically dependent on KPIs.... if you a young entrepreneur who is being encouraged to run a lean company it's very difficult to do that you have five or ten million Rand in your bank account.”

Regardless of the approach and allocation provisions used. A clear consensus was found across all the cases. In the end, VCFs are either investing capital on behalf of third-party investors or parent entities. Therefore, as they are investing capital into high risk entrepreneurial enterprises with perpetual incentive challenges compounded by asymmetric information. To satisfy their financing constraint the ability to influence material decisions is evidently important. As a result, shifting control from the EN on matters which can materially impact the VCs invested capital is critical. However, each of the VCRs highlighted the importance of the building a long-term relationship with the entrepreneur. As result, the requirements and incentives of the EN cannot be neglected in the pursuit of satisfying the financier's restraint. The allocation of control must still account for this. Therefore, although shifting control to mitigate against downside is necessary. Across the cases, it was stressed that allocation of control rights should be done to build relationships by being balanced and done in a manner that is fair and equitable to both parties.

VCR1: “You never give away control.... The only way you not going to be in control is to give control away. There is too much at stake to not be in control.... It is not to laud it over them, but.... if the VC is not in control it is a scary thing for investors and entrepreneurs”

VCR1: “It's a healthy balance where the entrepreneur is seeking out your strategic guidance and input, but feeling like he is making the decisions himself.”

VCR1: “It has to be a partnership.”

VCR2: “What you don't want to do is be a dick. You are busy building a relationship here right from the start. So, if I put in clauses that that are just not cool.... Then at some point.... This is not going to work if I'm forcing a guy into an agreement.”

VCR2: “I will never be unfair.... obviously, I want as good as possible deal but without having the other guy feel that I have screwed him. So that’s really key, you don’t want to walk away with this guy being pissed off... he mustn’t feel that he got screwed. You don’t want to screw people.... I am going to be in this thing for seven years.... Some point they are going to realise.”

VCR3: “It depends on the context. Our strategy involves us having majority most of the time. So, for us we want majority. So, there are reasons why we do that, and those reasons are around how we think about ourselves. And how we think about the role we play in the eco-system, and the role that we play for our investors.”

VCR3: “We ourselves are a company and we raise equity ourselves.... we are sitting on both sides of the table. We have investors and we are going to them and seeking following on rounds”

VCR3: “We will try and present them with a fair deal for them from day one.... Don’t try and play games like legal clauses and these sorts of things.... at the end of the day as an equity investor you are in it together so try and be fair to other one.”

VCR3: “VCs are not donors, they not rich guys trying to fleece other people. They have very specific business models, with very specific things that they need to achieve.”

VCR3: “It really depends on how the deal came about, what stage the business is on, and what the other parties are incentivised on. What is important to them.”

VCR3: “It’s a transaction of equals.... Think about how a transaction of equals should work.... Understand and agree on the level of information and involvement that should make sense to the VC and make that work.”

VCR3: “Any deal is a negotiation. So, we go into not asking for things that we believe is unreasonable.... So, we would go in with what is a fair set of things.... Your bringing something, the other side is bringing their business and you want to reach an agreement that satisfies both peoples objectives in the short term but also you want to build something that is great and going to leave both sides incentivised for the future. So, you don’t want to.... Drag the current shareholders over a barrel they completely just dis-incentivised that they going to leave. Then what have you invested in?”

5.3.1.1 Exertion of control

All with relatively small portfolios of entrepreneurial enterprises. Consistent across the cases was the active, frequent and close involvement of the VCRs in the portfolio enterprises in which they invest. Due to the fast-paced nature and evolving environments of the entrepreneurial enterprises, each of the VCRs saw the importance of regular weekly informal engagement to touch basis in addition to formal board and various monthly committee contact. In terms of monitoring, monthly financial reporting was required by VCF1 and VCF2, however VCF3 only required quarterly financial reporting. Predominantly involved in strategic advisory and supportive mentor type roles, each of the VCRs saw their role as a strategic partner in guiding the ENs in their business plan formulation and implementation by assisting them in making key decisions. In addition to these strategic and supportive roles, the VCRs would also play a networking role in assisting with recruitment of top talent, the sourcing of new partners, and the opening of new markets. Although actively involved, VCRs did not want to interfere in the day-to-day managerial activities of the entrepreneurial enterprises. Unless required to do so. However, made themselves available to assist in managerial activities as in the case of VCR1 or provided centralised services in the case of VCR3. Across the cases, VCF3 tended to be more involved in managerial activities.

VCR1: “We find it quite a high touch.... We are available to get involved to help through Manco [management committee] stuff during the month.... We do get involved in terms of a strategy point of view, and often cases with these businesses that move very quickly, if you only met them once a month you’d be left behind. So, we do meet quite regularly with the different teams.... The entrepreneurs use us really as strategic business support, as a sounding board, and we in touch with them on a regular basis”

VCR1: “We don’t tell the entrepreneur how to run his business. We guide him in the process.... It has to be a collective process at a strategy level.”

VCR1: “If we had to take control of everything, we are in the wrong business because we then should be running that business.... We are VCs.... We are there to blow wind in and support our founder. If we not prepared to do that, we have backed the wrong founder”

VCR1: “Strategy and where the business is heading we take a very serious role in that.... We have invested into X, don’t deliver us Y. if it changes why? Then we need to all be on par with that.”

VCR1: “There is one business that we have invested now, where a big part of what we doing is hiring in key staff. There is high involvement there in bringing staff in, but we not involved in doing day to day operations.”

VCR2: “I can be as active as we don’t have 50 portfolio companies, we got less but with bigger stakes.”

VCR2: “We want the companies to run like they want to be run.”

VCR2: “We should not be running the companies for them.... Where I do want to have control over is obviously where they spend my money.... Strategic decision making on where the firm is going. That is a joint decision as an investor that I should be party to. I don’t want to be involved on a daily basis on the nitty gritty of your firm.... Big transactions that can affect my valuation, on the value of my stake that’s the sort of thing I want to have control over.”

VCR2: “I would want someone who has some deep experience and connections that can open up doors for sales, for R&D. For me it’s really important. I could not see why you would not want it.”

VCR2: “We have taken companies in the UK and Germany and opened up markets for them in the US.... Because we have that global team.”

VCR3: “So we contact most of our portfolio weekly.... we get involved on a strategic level and then sometimes on particular functions where it is relevant.”

VCR3: “We also have some central services which we provide. We definitely network and do group deals and shared negotiations with providers.”

Although all cases presented show a clear reliance on the use of various formal provisions to influence the enterprises in which they invest. A clear consensus existed across the cases that critical to the success of the entrepreneurial enterprise is the relationship between the VCR and EN they invest in. Where the VCRs ability to influence

is most effective through regular and reciprocal relational contact. Seen as the last solution to resolving disagreement and conflict. Although, all cases stressed the importance of developing an effective working relationship, because of their financing constraint it was still important that they have sufficient protection should the relationship breakdown. As a result, it was still important to have the correct formal contractual provisions to fall back on should you need to.

VCR1: “Do you take control via governance, rules and regulations? If you do that you will miss the entrepreneur, and you will be on your backside... It is heavily relational dependent, and the guys look to you as.... one who actually helps and bring support to the business.”

VCR1: “It is a bit of both. We do stick to formal areas.... It is very much relationally driven.... but still you know when you managing third party money you have to have things crossed and dotted.... It’s a mix”

VCR2: “The best way is not in writing up. The investment agreement is always important so that if shit hits the fan we can go back and say you know our agreement says you not allowed to spend this amount of money without first asking me. You not allowed to employ anyone who cost this much without first asking me”

VCR2: “What I find the most useful is the weekly engagement. Engaging often and actually becoming in some way part of their team. But not a.... some controlling freak but rather you are suggesting approaches all the time every week.... in a supportive manner. You would rather build that collaborative relationship over time because then we are all doing what we want to do, and we can get to point where I did know where they were going an suddenly it comes back to me and I have to assert control. I always stay in touch with them so closely on a weekly basis, we do things together, that we make decisions on a weekly basis together.... That’s the best influence I think we can get.”

VCR2: “We can control through this regular engagement far better the strategy where this firm is going than anyone else with an agreement.”

VCR2: “When you lose relationship control your resulting alternative, your backup is your contractual agreement.... and then you start pulling out your board power.”

VCR3: “Is absolutely via relationships. It’s around have a shared sense of objectives and share understanding of how we get there. And exerting influence by making suggestions about how we best achieve those objectives.... if that breaks down then you have to fall back on the next level which would be more antagonistic board level conversations and worse case is legal fights.”

VCR3: “Legal provisions in my mind are a worse case if something happens.”

The breakdown of working relationship was seen by the VCRs as greatest threat to the investment. Across all cases a breakdown would result in the use of the formal control provisions or other punitive measures to protect invest capital. Where the breakdown in relationship led to disinvestment by VCF1, even after they tried to exert some of their formal control rights. The refusal to make follow on investments in case 2 by VCF2, and the removal of the founder or CEO in case 3 by VCF3.

VCR1: “We exited after 5 months. There was.... some financial mismanagement that we not happy with. When we tried to exercise some control over that.... we became at odds with rest of the team.”

VCR2: “We have refused to do follow on”

VCR2: “If you don’t have confidence, you have the ability to replace the CEO. If you reach that point of having to force out the CEO then things are not looking very pretty.”

VCR3: “We have had breakdowns in the relationship in the sense we no longer felt that the founder or the CEO is the right person for the right job and in those cases on occasion have replaced them.”

The importance of flexibility in the exertion of formal control provisions was also evidently clear. Although, they are required to provide sufficient protection against a myriad of challenges. Discretion should be carefully applied in their enforcement or application. Blanket enforcement should be guarded against especially in the building of more critical relationships shown to be more effect in influencing behaviour. VCR1 emphasised that formal control mechanisms should not be a punitive measure. Rather be used as a tool to keep focus and drive the correct behaviour. This was evidently apparent in the use and application of milestones by VCF1 and VCF2. Although, ENs had failed to achieve

certain prescribed milestones, as it was not a consequence of EN action or failure to deliver, discretion was or would have been applied when milestones have been missed.

VCR1: “In the one case we had a milestone....at the outset of the transaction...the entrepreneur said I will sign on X number of partners....and that was one of the milestones....it was all on track, it was moving well but it was getting there to the end of the runway and the milestone was available and we could see that progress was been made and it was inevitable, but it was caught up as part of the bureaucratic process. So rather than say no sorry for you there is no money coming in we actually released the milestone as loan into the business and converted into equity on achievement of the milestone.”

VCR2: “However, if you put those milestones it’s very to come up with proper milestones. The milestones are always.... Subjective”

VCR2: “Of course, there is leeway. You put them there and if you are sitting there and you reach a point and these guys are doing really well and they have done a lot of progress. Yes, they haven’t hit what we have contracted.... I like it and we are going in the right way we will release the payment.”

5.3.2 Moderating factors influencing the optimal level of control

In line with the argument put forward in chapter 2. In exploring the moderating factors influencing the optimal level of control, the results of the retrospective discernments, attitudes, opinions, and perceptions of the sampled VCs operating the three venture capital firms have been presented on the VC’s relative bargaining power, the VC’s perceived level of trust and confidence in the EN, and the VC’s preferred approach.

5.3.2.1 The VC’s relative bargaining power

Across each case, the relative bargaining power of the VCFs could be considered stronger than that of the ENs in which they invested. However, the VCs relative bargaining power did not materially affect the control provisions required. The VCRs preferred approach and perceptions of risk had the greatest influence in determining which control provisions were included in the agreed term sheets. Although both open to, expectant of, and encouraging of negotiation. VCFs operated in certain environments and with preferred approaches which dictated non-negotiable provisions which without

them they would not invest. Therefore, although to a degree could certain elements of the provision requirement be negotiated as the liquidation preference multiple, the performance milestone metrics, the agreed valuation and equity holding for example. Ultimately the satisfaction of the VC's financing constraint was critical in conclusion of contractual agreements, and that meant the inclusion of certain non-negotiable provisions. However, the severity and resultant implications of those provisions could be negotiated

VCR1: "We were prepared to go to a certain level but not beyond that. So that if you wanted us invested, this is how it is going to work. It is not a take it or leave it attitude these are the parameters that we operate in, and we can't operate beyond those parameters."

VCR2: "Typically the guy who has the money has the upper hand."

VCR3: "It depends on the start-up.... South African eco-system is very early stage and very underdeveloped. And most entrepreneurs are not particularly well equipped for building really successful businesses and so that's one of the reasons why we err on the side of more control."

5.3.2.2 The VC's perceived level of trust and confidence in cooperation with the EN

Across the cases, the perceived level of trust and confidence in cooperation was viewed as very important in determining whether to invest initially. As VCs and ENs are working closely together and are reliant on each other for the ultimate success of the entrepreneurial enterprise. Any perceived deficiency was viewed as a non-starter. Resulting in non-investment regardless of the underlying potential attractiveness of the entrepreneurial enterprise. Key across the cases in assessing this perceived level of trust and confidence in cooperation was the relational fit between the VCRs and the ENs they invested in. Not only did there need to be a personal chemistry where they must like each other and get on. Critically there needed to be a congruence or alignment across general business, the vision for the enterprises, and the enterprise's business plan implementation. As it was in the absence of this personal chemistry and or alignment, where relationships would most often breakdown. A central part of the due diligence process. The importance of evaluating this relational fit was highlighted by the VCRs all using background and reference checks through their networks and the multiple conversations they would have with the ENs before investing.

VCR1: “We get so involved we can’t not have relation fit.”

VCR1: “There has got be chemistry. If you an entrepreneur and I am going to invest in you it’s a very bad start, and I don’t like you it’s a very bad start. There has got be a chemistry upfront.”

VCR1: “We ask ourselves the question, can we work with these people? We do reference checks on these people.... to get a fuller picture of the individual.... There are flags that we look for.... If we don’t trust them, we can’t do business with them.”

VCR1: “We have seen one of our entrepreneurs was very reluctant to hand over the reins of one of the bank accounts. These guys by their very nature have varying elements of control that they don’t like to give away and they going to have to come to the realisation if they wanted complete control they should not have bought on a VC”

VCR1: “Different guys come with different levels of agreeableness.... it is bad business for you to be on the same page. Big part of our due diligence process is to find common ground on agreeing on business before we invest.”

VCR1: “We do reference checks on people in the different circles to get a fuller picture on the individual.... The networks are very small. So, when you invest in someone you investing in them because they have been referred to you by someone or you know of someone who knows someone who knows someone who has opened the door for them to meet with you. So, there is ways of going about understanding the background of the individual.”

VCR2: “You can have confidence early on, but you can only really know after some time.”

VCR2: “Integrity is a given. Do I trust you.”

VCR2: “There were some serious learnings, on do I think these guys are competent people ordinarily.... Or do I like them, and the do I like them to me is actually even more important.... My ability to work with them on a weekly basis is critical.”

VCR2: “Not being aligned on where the business should be going. And that you need to align on very early on. Before you make any investments.”

VCR2: “This is another lesson learned.... When you in put some performance clauses.... If those performance clauses are not aligned to what these guys want to do... will this is there business strategy. Then at some point it’s going to break down. Because you might say I want you to do this.... If you [are] forcing them into that direction, that’s where you break down.”

VCR2: “Certain guys come with a certain degree of agreeableness.... Its bad business for you not to be on the same page. A big part of our due diligence process is the ability to find common ground on agreeing on business before we invest it.”

VCR2: “My job is to vet. When I do my due diligence do I believe in this management team. Have I vetted them properly? Can they do their job?”

VCR2: ““Having trust in the most senior guy is critical. We run background checks.... If you don’t trust them then we can’t do a deal with you, full stop”

VCR3: “We need to be able to work together with the entrepreneurs and feel that they are receptive to our input.”

VCR3: “We try and explain to our partner, what we are looking for and what is important to us. When everyone is on the same page and understands what everyone is looking for and as long as those things are compatible.”

VCR3: “I.... would never use legal provisions to taper over a trust deficit. Because legal provisions in my mind are to used in the worst case if something happens. If you going into a relationship expecting to use legal provisions, it’s a failure from day one.... It’s very much like a marriage, you do an ante nuptial contract because things might go wrong in the future. But if you go into a wedding expecting to use the ante nuptial contract you shouldn’t be getting married.”

VCR3: “It’s kind of like a hiring process, interviews, conversations both formally and over dinner. It would be reference checks where possible by network.... Then It would be a lot of conversations around incentives and why people do what people do.”

Although confidence in cooperation was viewed as important. Complete agreeableness was however viewed negatively across each case. A challenged faced by the VCRs is

that ENs will sometimes do anything to raise the funding, then revert to their initial intentions once investment is made. Therefore, in conjunction with alignment. Key to the success of the relationship is the importance of negotiation, disagreement and open debate to come to agreement on key decisions was stressed across the cases. As this would not only reflect how EN would most likely interact not only with other key stakeholders such as customers, suppliers and other financiers.

VCR1: “We have seen one of our entrepreneurs was very reluctant to hand over the reins of one of the bank accounts. These guys by their very nature have varying elements of control that they don’t like to give away and they going to have to come to the realisation if they wanted complete control they should not have bought on a VC”

VCR1: “However they negotiate with you, is how they going to negotiate with their customers or their suppliers which is your suppliers and your customers at the end of the day.”

VCR2: “Sometimes entrepreneurs all they want is your cash, and they will do anything for the money.... When someone will do anything to take your money, then once they got the money they revert back to what they wanted to do anyway.... That’s the challenge”

VCR2: “You also just don’t want a guy who agrees with everything you say. You want him to debate it with you. But based on some facts. Usually these guys know a lot more about the industry.... than the investor does. Because they are actually in the business and working in it.... agreeableness is important but not that important.... Because there are also other investors and other customers, and if he is too agreeable he will be going down a bunch of different paths every time.... Open to debate, open to new ideas.... But more importantly, most importantly in my mind is that we both have the same vision for where this thing is supposed to be going.”

VCR3: “We would also not be excited with a CEO who is a walkover who is going to accept whatever we say, because they will accept what anybody says. So, we are more interested in people who are aligned on the business plan, the vision, and kind of culturally what’s important in an organisation. So that we can have robust debates from the same starting place and they will.... listen seriously to what we say and will push back when they don’t agree, and we can have debate and come to a back driven

conclusion. So, we definitely care about our ability to influence, but we would focus on cultural compatibility rather just agreeableness.”

5.3.2.3 The VC's preferred approach

Although a variety of common and standard control provisions were shared across each of the cases. Divergent approaches and unique control provisions required by each of the VCFs could be found across the different cases. Each VCF also applied these shared common or standard provisions in different and varying combinations in accordance with their preferred approach. It was also noted that although provisions may be standardised the severity or implications would be tailored in accordance with transaction particulars for example performance milestones and liquidation preferences would be different for each entrepreneurial enterprise.

For instance, in case one, VCF1 applied a standardised approach with no variation in terms of removing or adding provisions contained in their term sheets. VCF1 had the unique provision of internalising the booking keeping and having to be a signatory on specific bank accounts of their portfolio companies included in their term sheet. While having no liquidation preference provisions such as those required by VCF2 and VCF3, but sharing vesting share and put options and the use of special resolutions and reserved matters. For instance, in case two, VCF2 applied a standardised approach with some tailoring dependent on the transaction. While sharing provisions such drag-along and tag-along with provisions with VCF3 and milestones with VCF1. VCF2 made unique use of non-competition & non-solicitation agreements, veto rights at the board level in response to a syndicated partner having greater knowledge about a transaction than they did, and the appointment of independent director on the board. For instance, in case three, VCF3 preferred to apply a lot of tailoring to each of its transactions. Preferring to take majority equity provisions with standard symmetrical rights as implied in the financial transaction, however requiring the separation of cash flow and control rights ring using reserved matters when taking a minority equity position. As a result, the term sheet varied considerably in terms of the provisions required.

VCR1: “We lock the entrepreneur in for a certain time frame. We do have certain put options in place for that.... We tie them in for a five-year period.”

VCR1: “We do have a standard set of control mechanisms that we put in place.”

VCR1: “We haven’t put in any in terms of preference on liquidations. We have taken the view on liquidations that we come straight in as common shareholders.”

VCR1: Part of what we have done in terms of control.... We took a decision to actually internalise the accounting and book keeping services.... Bring it in house and let’s take control of the bank accounts. When I say take control, have a signatory on the bank accounts.”

VCR2: “Most of term sheets are a little bit tailored.”

VCR2: “Sometimes we actually enter on a convertible note.... As per the tranche in the milestones.”

VCR2: “In recent transactions we have included some specific veto rights. That is because some other investors have had more insight in the transaction than we had. So, we would then include veto rights on the final documents, certain purchases, that sort of thing.”

VCR2: “We typically have one in four on the board.... And we will ask that the 4th representative be elected independently by unanimous consent of the three.”

VCR3: “We don’t have a fund structure, we can tailor deals that make sense.”

VCR3: “Every deal is kind of different.”

VCR3: “If you have really top tier entrepreneurs doing repeat businesses etc. then it makes more sense for investors to get out the way and let them run.”

Across the cases, the VCFs preferred approach have been shaped by a variety of underlying or moderating factors. The most prominent of these have been learning through experience, the VCF’s location of focus and its fixed effects, the VCF’s organisation type and its fixed effects, and the VCF’s investment stage preference. Sticking to a standard set of provisions, learning through repetition was found to be key across all the VCFs in adjusting their preferred approach. Valuable learnings from each iteration of applied would be applied to each new investment transaction. The VCF’s location of focus also had a major impact on the approach taken. As VCF2 was investing in countries with more sophisticated venture capital markets. It was often involved in

syndicated transactions which would entail multiple financing rounds with multiple syndicated partners. As a result, it would take lower equity provisions and use preferred equity and even convertible notes in conjunction with greater protection of its holding through additional provisions contained in its term sheet. Specifically, in terms of controlling its exit through anti-dilution provisions and the requirement of an independent board director to be nominated by unanimous agreement to improve the resolution process of conflicts of interest which need to be solved at a board level. Regarding VCF's organisation type. Not restricted by regulation regarding the composition of their portfolio, the equity holding they can take, and type of shares to be taken. VCF2 and VCF3 can take global best practices and incorporate them into their preferred approach. As a result, unlike VCF1 which is limited to the use of common equity, VCF2 and VCF3 can make use of preferred equity and apply other provisions to their agreements not available to VCF1. Investment stages also played an influence the control provisions used. Focusing on development stage capital, the use of performance milestones were not a prominent feature in VCF3's preferred approach in comparison to VCF1 and VCF2 who both used milestones extensively as were more focused on earlier investment stages which entailed greater risk.

VCR1: "We learned quite a bit from one of the earlier investments we exited."

VCR1: "In the other.... It resulted in some behavioural issues which weren't best for the business and, so we reviewed that as we went...Again not taking away from the essence of the deal, because the deal was the deal but it did require us to based on the entrepreneur understand what is actually best for the business here."

VCR2: "We have taken a lot of learnings.... From near death misses"

VCR2: "All our investments our global."

VCR2: "We don't always invest alone of course... Usually there is a couple of VC guys that comes in a round. We have done things where there is seven, eight VCs investing in the same round. Often it is just two of us."

VCR2: "Then at least the founder is comfortable that with an independent director.... We know now that he is not the buddy of the board director, he also does not now have shares or some interest in the business, he is really looking at it from an independent point of view. Not like we might be emotional about a certain decision as an investor and

the investors might vote together on a certain issue, and as an independent observer he might say no well actually you know I agree with.... The CEO”

VCR3: “It really depends on how the deal became about. What the stage of the business is and what the other parties are incentivised on. What is important to them. One our strengths is that we don’t have a fund structure or pre-defined mandate etc., we can tailor deals that make sense.”

VCR3: “So, our starting point is very much what happens internationally.... Global practices. And we have subsequently tweaked as our business model has changed slightly based on experience. So, this topic around majority has become more important to us over time.”

5.3.3 Suggestions to achieve more optimal cooperative outcomes

In line with the argument put forward in chapter 2. As ENs have limited influence in changing the VC’s relative bargaining power or the VC’s applied approach. In exploring suggestions to achieve more optimal cooperative outcomes, the results of the retrospective discernments, attitudes, opinions, and perceptions of the sampled VCs operating the three venture capital firms have been presented on how to improve trust and confidence in cooperation between the VC and EN.

5.3.3.1 Improving trust and confidence in cooperation

Critical in achieving more optimal cooperative outcomes through the improvement of trust and confidence in cooperation was the working relationship between the EN and the VC. Requiring time to develop, evident across the cases was the importance of alignment. When deciding to seek outside funding, ENs need to understand and appreciate the VCF’s financing constraint. What that specifically entails and how to best satisfy that in terms of their behaviours and actions. Important to that is open, honest and transparent communication. Although not actively involved in the actual day-to-day management of these enterprises. The VCFs have responsibility to their investors and need to be kept informed of the on-goings of their investments. A lot is a stake and key to the success of the entrepreneurial enterprise is the open sharing of vital information which can enable the VCF make better informed decisions. It always more beneficial to share information willingly and more importantly proactively. As detailed above, the breakdown in working relationships can lead to the exertion of formal contractual

provisions such as removal of the founder, not following on and even disinvestment. This was illustrated in case 1, where the omission and inaccurate reporting of information damaged relationship and VCF1 divested. Working relationships are reciprocal. ENs should not feel like they are being taken advantage of. Key in improving the working relationship from the VCFs side was ensuring fair and balanced deals, and treating the EN equitably by going through the term sheets with them to ensure they grasped all the implications of the agreed upon conditions of the transaction. Going through the term sheets was more applicable for VCF1 and VCF3, because of VCF2 operating in more sophisticated venture capital markets, this was not seen as important due to the level and sophistication of the entrepreneur who had often gone through the process in subsequent rounds.

VCR1: “There has got to be an openness. What we do look for, there are certain people that talk team and collaborative but act very much individualistic.”

VCR1: “In the one business we exited. We exited that. We did not have comfort over the numbers that were coming through. There were some big question marks of the transparency and accountability in the process. When we raised alarm bells and requested information didn’t come. We took the view if this is what it’s like at the start of the relationship, we not hanging around for the end of it. That’s the one we exited as it is important that we had line of sight of that”

VCR1: “Guys need to know what they are getting into.... We go through the thing step by step, painstakingly through it to make sure they understand it. So, invariably by us doing that, when you unpack it you get to the essence of what is behind the agreement. The agreement is only as good as the two people, or three or four people signing it. So, even at that stage there is an element of trust that I am taking you through the agreement. This is what it says, this is what it means.... When you unpack it, you get the essence behind it.”

VCR2: “Building trust from transparency. So, Entrepreneurs, some of them, they don’t tell you everything. They are not always transparent, and you have, feel sometime that’s you have to force information out of them. And my suggestion would be as transparent as possible you have nothing to lose and only to gain. You will be in a far worse off situation if you are hiding things and later on then the investor finds out.... It’s all about transparency.... I don’t want to be involved in the day-to-day decisions, but I want to chat

to you on a weekly basis.... What are we doing? How are we moving this forward? How can I help? And you have to be very transparent.”

VCR2: “Because we not SA investor, typically when we have gotten into firms, you know these guys are on round two [&] three with valuations of \$50 million dollar plus.... These guys know how to raise money, they know the terms, they very astute.... They have their own council.... They quite experienced.”

VCR3: “If you help them achieve that everyone will be happier.”

VCR3: “We try and write very simple term sheets and spend the time to talk through them.”

5.4 Chapter summary

Having presented the details and defence of the research design and methodology. This chapter presented the cases and results of cross-case findings. The cross-case findings are summarised in the table below. The next chapter discusses results in terms of the research propositions and academic literature.

Table 8: Chapter 5 Summary

The optimal level of control	
Allocation of control	Key to the alignment of EN and VC behaviour and protection of invested capital, is the separation of cash flows and control rights when holding minority positions by locking in the EN through vesting shares and put options, and the use of staging and performance milestones. Although control should always shift in accordance with the VC’s financing constraint, relationships are reciprocal and as a result, must still maximise the ENs incentive to exert maximum effort by being equitable and fair
Exertion of control	VC’s are actively involved in the portfolio, enterprises playing strategic, supportive, networking, and when required managerial roles. Informal relational control is the most effective method of exerting influence, however formal control

	provisions are still required in the event of a relationship breakdown. Formal control should be applied flexibly.
Moderating factors influencing the optimal level of control	
The VC's Relative bargaining power	Does not materially affect the control provisions required. The VCFs preferred approach and perceptions of risk had the greatest influence in determining the control provisions required.
The VC's perceived level of trust and confidence in cooperation in the EN	Important to the initial investment decision as any deficiency will not result in investment. This is determined by relational fit in terms of personal chemistry and alignment. However, there should be not be complete agreeableness.
The VC's preferred approach	Both standardised and tailored, the VC's approach is shaped through experience, the VCF's location of focus and its fixed effects, the VCF's organisation type and its fixed effects, and the investment stage preference.
Suggestions to achieve more optimal outcomes	
Improving trust and confidence in cooperation	Key in improving trust and confidence in cooperation, is the working relationship between ENs and VCs. Governed by relational fit, ENs should understand the VCs financing constraint and align their behaviour accordingly and ensure open and transparent sharing of all pertinent information which impacts this constraint. As this relationship is reciprocal

Chapter 6: Discussion of Results

6.1 Chapter introduction

To gain an understanding into the optimal level of control in venture capital to enable the attainment of more optimal cooperative outcomes. This multiple case study research aims to explore what the optimal level of control is, explore what moderating factors influence this optimum level, and explore what suggestions could achieve more optimal cooperative outcomes. By investigating optimality through a cooperative rather than a competitive exchange perspective to provide insights into how and why different allocation arrangements and exertion methods are applied across three cases of South African VCs operating different types of seed, start-up, growth, and development stage venture capital firms. The three types of venture capital firms presented in the cases for this study were an an independent Section 12J Venture Capital Company, a corporate captive, and an independent investment entity. Having presented cases and results of the cross-case analysis. This chapter discusses results in terms of the research propositions and academic literature.

6.2 The optimal level of control

Proposition 2: *The optimal level of control should satisfy the venture capitalist's financing constraint by enabling the venture capitalist to monitor and direct entrepreneur behaviour to ensure invested capital is used appropriately, while maximising the entrepreneur's incentives by being more relational than formal, more supportive than interfering, and more strategic than managerial*

The data showed that the investment approaches of and control provisions required by the VCRs varied across each of the cases. However, critical to each VCR was the ability to formally influence and alter material decisions to protect invested capital regardless of the equity holding. As a result, when minority equity positions were taken, common across all the cases was the separation of cash flow and control rights using board representation, and special resolutions and reserve matters. These findings are supported by prior research on US VCs regarding the separation of control rights. Literature on US VCs puts forward that VCs are concerned with the level to which they can mitigate behaviour uncertainties and agency conflicts to deliver on desired objectives (Drover, Wood & Tyge Payne, 2014). Where the ability to monitor and direct an EN's actions during the post-investment period to ensure invested capital and resources are

being employed appropriately is important (Kaplan & Strömberg, 2003; Tyge Payne, Davis, More & Bell, 2009; Geringer & Hébert, 1989). Although VCs first obtain formal control through the equity stake purchased. VCs require increased control beyond the level inferred in the financial transaction by insisting equity claims come with disproportionate control (Burchardt, Hommel, Kamuriwo, & Billiteri, 2016). By separately allocating cash flow and control rights to retain or relinquish control (Burchardt, Hommel, Kamuriwo, & Billiteri, 2016; Kaplan & Stromberg, 2001). So, that even if the VC has a minority holding, he or she will maintain effective control (Jia, 2015).

The data showed, that key in each case was the importance of alignment of VCF and EN incentives. Common across each case was the use of vesting shares and put options to tie the investor down. Also, common was the staging of committed capital in tranches. Although more prevalent in case two and case three as VCF1 and VCF2 were targeted at earlier seed, start-up and growth investments stages. It was less prevalent in case three as VCF3 which predominantly focused on the development investment stage. Naturally as earlier investment stages come with greater uncertainty and increased illiquidity. The release of these tranches was shown to be contingent on the fulfilment of predetermined performance milestones. These findings are supported by prior research on US VCs regarding the use of downside protection mechanisms such as contingencies. Prior research put forwards that VCs seek downside protection where key is the ability to vary the level of control contingent on performance (Burchardt, Hommel, Kamuriwo, & Billiteri, 2016; Jia, 2015). Applied through a combination of staging, convertible securities and complementary contractual covenants, the distribution of cash flow and control rights is typically contingent on the fulfilment of financial and non-financial performance measures during episodic EN evaluations (Burchardt, Hommel, Kamuriwo, & Billiteri, 2016; Cornelli & Yosha, 2003; Kaplan & Strömberg, 2004; Tian, 2011). VCs structure contractual agreements to specify performance milestones as benchmarks for evaluating portfolio enterprise performance in respect of enterprise pacing of business plan implementation (Bengtsson, 2011). Where the use of contractual contingencies by VCs is particularly prominent for earlier-stage, R&D-intensive, and pre-revenue types of EN enterprises where large amounts of investments are required preceding production (Jia, 2015).

The data showed a clear consensus that critical to the success of the entrepreneurial enterprise is the relationship between the VCR and EN in which they invest in. Where the VCRs ability to influence is most effective through regular and reciprocal relational contact. Seen by the VCRs as the last solution to resolving disagreement and conflict.

Although, in each case, the VCRs stressed the importance of developing an effective working relationship, because of their financing constraint it was still important that they had sufficient protection should the relationship breakdown. As a result, it was still imperative to have the correct formal contractual provisions to fall back on should you need to. The breakdown of working relationship was also by the VCRs as the greatest threat to the investment. The importance of this working relationship and requirement of supporting formal controls was highlighted across the cases. Where breakdowns led to disinvestment by VCF1 in case one, even after they tried to exert some of their formal control rights. The refusal to make follow on investments in case two by VCF2, and the removal of the founder or CEO in case three by VCF3. However, also important was flexibility in the exertion of these formal provisions as evidenced by the application of the performance milestones provisions across case one and case two when measures were not met. These findings are supported by prior research on US VCs regarding informal relational control. Prior research puts forward that venture capital investment transactions rely on relational norms where it is suggested that the VC-EN relationship is impacted more meaningfully through interaction and reciprocal relationships rather than through formal mechanisms of control (Sapienza & Korsgaard, 1996; De Clercq & Sapienza, 2001; De Clercq & Sapienza, 2006; Busenitz, Fiet, & Moesel, 2004). Where the inability to develop effective working relationships is regularly regarded as a leading reason behind failed EN enterprises (Nahata, Hazarika & Tandon, 2014). However, the problem is that VCs still need to mitigate incentive challenges which can often necessitate complicated contracts whose implications are very difficult to decipher (Bengtsson & Bernhardt, 2014a). Optimality in terms of allocations is argued to be achieved through the combination of governance mechanisms and incentives (Tyge Payne, Davis, Moore, & Bell, 2009). So that it will enable trust in the relationship to develop and thereby produce the greatest level of confidence in cooperation between VCs and ENs (Cestone, 2014; Shepherd & Zacharakis, 2001). Emphasising the importance of flexibility and signifying that formal control should be applied frugally to retain effectiveness (Fried & Hisrich 1994; Hatherly, 1994; Sweeting, 1991).

The data showed that regardless of the approach and allocation provisions used, as the VC is investing on behalf of third-party or a parent entity, there was clear consensus across each case that control needs to shift from to the EN to the VC to satisfy the VC's financing constraint. However, clear across the cases was balance. In shifting control through the allocation of control rights, any agreement must still consider the EN by not unfairly imposing provisions which could impact the working relationship. These findings are supported by prior research on US VCs regarding the allocation of control rights.

Prior research puts forward that attaining and shifting control is considered a main motivation in venture capital transactions (Fluck, 2010). Where optimality in terms of allocation of control rights should satisfy the VC's financing constraint while adequately providing the best possible incentives for the optimal exertion of effort from the EN (Yerramilli, 2011; Burchardt, Hommel, Kamuriwo, & Billiteri, 2016).

The data showed that due to the relatively small portfolios, consistent across the cases was the active, frequent and close involvement of the VCRs in the portfolio enterprises in which they invest. Although the VCRs did not want to interfere in the day-to-day managerial activities of the entrepreneurial enterprises. The VCRs viewed their involvement in strategic advisory, supportive, and network types of roles. Guiding the ENs in their business plan formulation and implementation, assisting with the recruitment of top talent, sourcing of new partners, and the opening of new markets. However, when required assist with managerial functions were relevant. VCR3 tended to be more involved in the managerial activities because of its greater formal control in terms of majority equity positions. These findings are supported by prior research on US VCs regarding the involvement of VCs in the enterprises in which they. Prior research puts forward that the quantity of active investments in the VC's investment portfolio sets out how involved the VC can be (Wang, Zhou & An, 2017). Where VCs to be able to significantly interfere in the enterprises in which they invest requires formal control rights as a result when formal control rights are granted to the VC, the VC is induced into excessive interference which destroys entrepreneurial enterprise (Cestone, 2014). VCs are classified into a typology of strategic, supportive and networking roles where the most important value-added is delivered through a combination of strategic advisory and supportive mentor roles (Sapienza, Manigart & Vermeir, 1996). Where the optimal balance between formal control and relation norms should be aligned with strategic rather than managerial involvement (Yitshaki, 2012).

The data shown and discussed with literature above clearly supports the proposition put forward. It can therefore be argued that optimal level of control should satisfy the venture capitalist's financing constraint by enabling the venture capitalist to monitor and direct entrepreneur behaviour to ensure invested capital is used appropriately, while maximising the entrepreneur's incentives by being more relational than formal, more supportive than interfering, and more strategic than managerial.

6.3 Moderating factors influencing the optimal level of control

Proposition 2: *The optimal level of control is a function of the venture capitalist's relative bargaining power, the venture capitalist's perceived level of trust and confidence in cooperation with the entrepreneur, and the venture capitalist's preferred approach, where the venture capitalist's preferences in conjunction with their own perceptions have the greatest influence*

The data showed that bargaining power does not materially affect the control provisions required. The VCFs preferred approach and perceptions of risk had the greatest influence in determining the control provisions required. Each VCR applied shared, common and distinct provisions in different and varying combinations in accordance with their preferred approach. Where the VCFs preferred approach had been shaped by the learning through experience, the VCF's location of focus and its fixed effects, the VCF's organisation type and its fixed effects, and the investment stage preference. This is supported by prior research on US VCs regarding the variance in levels of controls. Prior research puts forward that it can be argued that ultimately the varying levels of control in venture capital transactions are linked to individual VC perceptions of risk and their own preferences (Tan, Zhang & Xia, 2008). Not materially related to the nature of the entrepreneurial enterprise, varying levels of involvement is the choice exercised by VCs regarding the universal approach they wish to implement (MacMillan, Kulow, & Khoylian, 1989). Many factors affect the level of involvement and control sought by VCs (Tan, Zhang & Xia, 2008). These include the entrepreneurial enterprise's investment stage, the VC's location of focus and its fixed effects, the VC's organisation type and its fixed effects, the preferred management style of the VC, and level of previous experience and knowledge of the ENs and VCs (Wang, Zhou & An, 2017; MacMillan, Kulow, & Khoylian, 1989; Sapienza & Gupta, 1994; Payne, Davis, Moore & Bell, 2009; Bengtsson & Bernhardt, 2014a; Drover, Wood & Payne, 2014).

The data showed that common across each case, was the application of a specific set of standard non-negotiable provisions where the severity and resulting implications would be adjusted in accordance with the transaction's specific characteristics and can could be negotiated on. Although in case one, VCF1 did not add or remove provisions form its term sheet. In case two and case three, VCF2 and VCF3 would tailor accordingly by adding or omitting provisions as when required based on the transactions characteristics. As VCF3 employed varying approaches in terms of the equity holding taken, naturally this tailoring was more pronounced in case three. This was supported

by prior research on US VCs regarding contract specialisations. Prior research puts forward that VCs concentrate on a constrained set of combinations for a given investment opportunity where repetition results in the VC making improved funding and monitoring decisions (Bengtsson & Bernhardt, 2014a). As the VC becomes more knowledgeable about the payoff, incentive and action consequences, VCs adjust what their own optimal approach should be as circumstances evolve (Bengtsson & Bernhardt, 2014a). Importantly, VCs do not use a one size fits all approach (Bengtsson & Bernhardt, 2014a). Utilising approaches and solutions which are familiar, VCs tailor their approaches to alleviate issues specific to each investment (Bengtsson & Bernhardt, 2014a).

The data showed that across cases the perceived level of trust and confidence in cooperation was viewed as very important in determining whether to invest initially. As any perceived deficiency was viewed as a non-starter. Key in determining this was the relational fit between the VC and EN. There needs to be a personal chemistry where the VC and EN must like each other and get on. Critically there needed to be a congruence or alignment across general business, the vision for the enterprises, and the enterprise's business plan implementation. As it was in the absence of this personal chemistry and or alignment, where relationships would most often breakdown. However, there should be not be complete agreeableness. A central part of the due diligence process. The importance of evaluating this relational fit was highlighted by the VCRs all using background and reference checks through their networks and the multiple conversations they would have with the ENs before investing. This is supported by prior research on US VCs. Prior research puts forward that enterprise success is positively linked to the degree which ENs and VCs agree upon shared values and objectives (Bruton, Fried & Hisrich, 2000; De Clercq & Sapienza, 2006). Effective support can be considered dependent on better relation fit (Faber, Castaldi & Muskens, 2016). Better relational fit stimulates more open exchanges between the VC and EN enhancing enterprise performance through enabling better monitoring and the provision of appropriate support (Faber, Castaldi & Muskens, 2016). VCs pay extensive consideration to the perceived parallels and interpersonal chemistry with ENs in evaluating prospective enterprises (Shepherd & Zacharakis 2001; Franke, Gruber, Harhoff & Henkel, 2006; Murnieks, Haynie, Wiltbank & Harting, 2011). Enterprise attractiveness has been shown to be biased by interactions between VCs and ENs with VC assessed enterprise attractiveness being influenced by perceived cognitive similarities (Murnieks, Haynie, Wiltbank & Harting, 2011; Neergaard & Uihøi, 2006). VCs gain confidence in the predictability of the EN's future actions using insights from this relational continuity to assess if relationship

risk has been sufficiently reduced to prompt investment and the level of formal control they will require (Maxwell & Lévesque, 2011).

The data shown and discussed with literature above clearly supports the proposition put forward. It can therefore be argued that the optimal level of control is a function of the venture capitalist's relative bargaining power, the venture capitalist's perceived level of trust and confidence in cooperation with the entrepreneur, and the venture capitalist's preferred approach, where the venture capitalist's preferences in conjunction with their own perceptions have the greatest influence.

6.4 Suggestions to achieve more optimal cooperative outcomes

Proposition 3: *To achieve more optimal cooperative outcomes, venture capitalists and entrepreneurs should improve trust and confidence in cooperation by revealing private information new to the other and encouraging procedural justice by treating the other honestly and fairly*

The data showed that the working relationship between the EN and the VC was critical in achieving more optimal cooperative outcomes through the improvement of trust and confidence in cooperation. Taking time to develop. When deciding to seek outside funding, ENs need to understand and appreciate the VCF's financing constraint. Understanding why a VC requires something and then working together with the VC to achieve that is critical. Building the working relationship with the VC is also key. VCs will put in formal punitive measures in their term sheets and agreements. Failure to meet expectations will result in VCs exercising these measures which can have drastic implications for the EN. This does not entail being agreeable to every decision or request by the VC. But necessitates that the EN be open, honest and transparent regarding all information that would enable VCs to make more informed decisions and encourage the open debate required to make mutual decisions. This is supported by prior research on US VCs regarding trust in venture capital transactions. Prior research puts forward that critical to the success of entrepreneurial enterprises are the exchanges between ENs and VCs that facilitate a thorough understanding of each other's values, perspectives, and objectives (Collewaert, 2012). A prominent factor in fostering the level of trust between VCs and ENs is the degree of openness between them (Kollmann, Kuckertz & Middelberg, 2014). VCs frequently weigh potential agency and monitoring costs in evaluating and re-evaluating entrepreneurial enterprises (Tan, Zhang & Xia, 2008). ENs have direct access to vital private information that the VC requires to better comprehend

what is happening in the enterprise (Khanin & Turel, 2015). When ENs fail to meet expectations regarding their contractual obligations, VCs are likely to either replace them or take control of the enterprise (Bruton, Fried & Hisrich, 2000). To avert conflict escalation, ENs could profit from acting proactively and cooperatively in opening communication to improve their relationships with VCs (Khanin & Turel, 2015).

Working relationships are reciprocal. ENs should not feel like they are being taken advantage of. Key in improving the working relationship from the VCFs side was ensuring fair and balanced deals, and treating the EN equitably by going through the term sheets with them to ensure they grasped all the implications of the agreed upon conditions of the transaction. Going through the term sheets was more applicable for VCF1 and VCF3, because of VCF2 operating in more sophisticated venture capital markets, this was not seen as important due to the level and sophistication of the entrepreneur who had often gone through the process in subsequent rounds. This is support by prior research on US VC regarding trust in venture capital transactions. Prior research puts forward that working relationships are strengthened through regular interactions, VCs should strive to develop mentorship relationships through transparency about their principles to display integrity (Middelhoff, Mauer, Brettel, 2014). Although both ENs and VCs have stakes in the enterprise, the VC is commonly the more powerful party (Busenitz, Fiet, and Moesel 2004; Cable and Shane 1997). Enterprise success is dependent on the EN's perceptions of fairness in their relationships with VCs (Sapienza & Korsgaard 1996; Busenitz, Fiet, & Moesel, 2004). When the VC-EN relationship is characterised by honesty and fairness, the prospect of reaching more favourable outcomes for task-related conflict increases as ENs are more likely to feel that their input is appreciated and considered and that they have influence over decisions (Sapienza, Korsgaard, Goulet & Hoogendam, 2000; Korsgaard, Schweiger & Sapienza, 1995; Sapienza & Korsgaard, 1996).

The data shown and discussed with literature above clearly supports the proposition put forward. It can therefore be argued that to achieve more optimal cooperative outcomes, venture capitalists and entrepreneurs should improve trust and confidence in cooperation by revealing private information new to the other and encouraging procedural justice by treating the other honestly and fairly.

6.5 Chapter summary

Having presented the cases and results of cross-case findings. This chapter presented results in terms of the research propositions and academic literature. Which The next chapter discusses the conclusion of the research.

Table 9: Chapter 6 summary

Proposition 1	The data shown and discussed with literature above clearly supports the proposition put forward. It can therefore be argued that optimal level of control should satisfy the venture capitalist's financing constraint by enabling the venture capitalist to monitor and direct entrepreneur behaviour to ensure invested capital is used appropriately, while maximising the entrepreneur's incentives by being more relational than formal, more supportive than interfering, and more strategic than managerial.
Proposition 2	The data shown and discussed with literature above clearly supports the proposition put forward. It can therefore be argued that the optimal level of control is a function of the venture capitalist's relative bargaining power, the venture capitalist's perceived level of trust and confidence in cooperation with the entrepreneur, and the venture capitalist's preferred approach, where the venture capitalist's preferences in conjunction with their own perceptions have the greatest influence.
Proposition 3	The data shown and discussed with literature above clearly supports the proposition put forward. It can therefore be argued that to achieve more optimal cooperative outcomes, venture capitalists and entrepreneurs should improve trust and confidence in cooperation by revealing private information new to the other and encouraging procedural justice by treating the other honestly and fairly.

Chapter 7: Conclusion

7.1 Chapter introduction

To gain an understanding into the optimal level of control in venture capital to enable the attainment of more optimal cooperative outcomes. This multiple case study research aims to explore what the optimal level of control is, explore what moderating factors influence this optimum level, and explore what suggestions could achieve more optimal cooperative outcomes. By investigating optimality through a cooperative rather than a competitive exchange perspective to provide insights into how and why different allocation arrangements and exertion methods are applied across three cases of South African VCs operating different types of seed, start-up, growth, and development stage venture capital firms. The three types of venture capital firms presented in the cases for this study were an an independent Section 12J Venture Capital Company, a corporate captive, and an independent investment entity. Having discussed results in terms of the research propositions and academic literature. This chapter presents the conclusion of the research. This chapter discusses –

- The principal findings
- Implications for VCs and ENs
- Limitations of the research
- Suggestions for future research

7.2 The principal findings

7.2.1 The optimal level of control

Consistent with prior research on US VCs regarding the allocation of control rights. Key to the alignment of EN and VCF behaviour and protection of invested capital, is the separation of cash flows and control rights when holding minority positions by locking in the EN through vesting shares and put options, and the use of staging and performance milestones. (Kaplan & Strömberg, 2003; Tyge Payne, Davis, More & Bell, 2009; Geringer & Hébert, 1989; Burchardt, Hommel, Kamuriwo, & Billiteri, 2016; Kaplan & Stromberg, 2001). Although control should always shift in accordance with the VCF's financing constraint, relationships are reciprocal and as a result, must still maximise the ENs incentive to exert maximum effort by being equitable and fair Yerramilli, 2011; Burchardt, Hommel, Kamuriwo, & Billiteri, 2016). Also, consistent with prior regarding informal

relational control. VCF's are actively involved in the portfolio, enterprises playing strategic, supportive, networking, and when required managerial roles. Informal relational control is the most effective method of exerting influence (Sapienza & Korsgaard, 1996; De Clercq & Sapienza, 2001; De Clercq & Sapienza, 2006; Busenitz, Fiet, & Moesel, 2004). However formal control provisions are still required in the event of a relationship breakdown and will be exercised when expectations are not met. Formal control should be applied flexibly as not to induce excessive interference (Cestone, 2014; Fried & Hisrich 1994; Hatherly, 1994; Sweeting, 1991). The principal findings clearly support the proposition put forward. It can therefore be argued that optimal level of control should satisfy the venture capitalist's financing constraint by enabling the venture capitalist to monitor and direct entrepreneur behaviour to ensure invested capital is used appropriately, while maximising the entrepreneur's incentives by being more relational than formal, more supportive than interfering, and more strategic than managerial.

7.2.2 Moderating factors influencing the optimal level of control

Consistent with prior research on US VCs regarding the variance in levels of allocated control. The VCFs preferred approach and perceptions of risk had the greatest influence in determining the control provisions required (Tan, Zhang & Xia, 2008). Each VCR applied shared, common and distinct provisions in different and varying combinations in accordance with their preferred approach which had been shaped by the learning through experience, the VCF's location of focus and its fixed effects, the VCF's organisation type and its fixed effects, and the investment stage preference (Wang, Zhou & An, 2017; MacMillan, Kulow, & Khoynian, 1989; Sapienza & Gupta, 1994; Payne, Davis, Moore & Bell, 2009; Bengtsson & Bernhardt, 2014a; Drover, Wood & Payne, 2014). Applying a tailored approach, the application of a specific set of standard non-negotiable provisions would be adjusted in accordance with the transaction's specific characteristics and can could be negotiated on (Bengtsson & Bernhardt, 2014a). The perceived level of trust and confidence in cooperation was viewed as very important in determining whether to invest initially (Murnieks, Haynie, Wiltbank & Harting, 2011; Neergaard & Ulhøi, 2006). Key in determining this was the relational fit between the VC and EN where needs to be personal chemistry and alignment across shared values and objectives (Faber, Castaldi & Muskens, 2016; Shepherd & Zacharakis 2001; Franke, Gruber, Harhoff & Henkel, 2006; Murnieks, Haynie, Wiltbank & Harting, 2011; Bruton, Fried & Hisrich, 2000; De Clercq & Sapienza, 2006). The principal findings clearly support the proposition put forward. It can therefore be argued that the optimal level of control is a function of the venture capitalist's relative bargaining power, the venture

capitalist's perceived level of trust and confidence in cooperation with the entrepreneur, and the venture capitalist's preferred approach, where the venture capitalist's preferences in conjunction with their own perceptions have the greatest influence.

7.2.3 Suggestions to achieve more optimal outcomes

Consistent with prior research on US VCs regarding trust in venture capital transactions. Building the working relationship between the VC and EN is key in improving trust and confidence in cooperation with. As VCs will put in formal punitive measures in their term sheets and agreements and failure to meet expectations can have drastic implications for the EN (Bruton, Fried & Hisrich, 2000). To improve this necessitates that the EN be open, honest and transparent regarding all information that would enable VCs to make more informed decisions and encourage the open debate required to make mutual decisions (Kollmann, Kuckertz & Middelberg, 2014; Khanin & Turel, 2015). As working relationships are reciprocal, key is ensuring fair and balanced deals, and treating the EN equitably by going through the term sheets with them to ensure they grasped all the implications of the agreed upon conditions of the transaction (Sapienza & Korsgaard 1996; Busenitz, Fiet, & Moesel, 2004). The principal findings clearly support the proposition put forward it can therefore be argued that to achieve more optimal cooperative outcomes, venture capitalists and entrepreneurs should improve trust and confidence in cooperation by revealing private information new to the other and encouraging procedural justice by treating the other honestly and fairly.

7.3 Implications for VCs and ENs

From the VC's perspective, key is understanding the optimal balance across both the allocation and exertion of control. Relationships are reciprocal, and both the allocation of provisions and the exertion of influence needs to be balanced. To not only ensure that their own financing constraint is satisfied, but that the entrepreneur is still appropriately incentivised to exert maximum effort. Developing this relationship with the EN is critical to the ultimate success of the transaction. As a result, careful consideration should be given regarding their preferred approach in terms of the level and type of involvement and the application of formal provisions. As most relationships breakdown early on, relational fit is important. Key in determining this relational fit in terms of personal chemistry and alignment is the due diligence process. Where the use of staging and performance clauses can be effective in aligning behaviour, and protecting invested

capital. However due to the subjective nature flexibility and discretion in application is important.

From the EN's perspective, key in bringing in outside finance is understanding the implications around the VC's financing constraint. As these financiers are typically funded by either third-party investors or a parent entity, there is a lot on the line. Understanding why a VC requires something and then working together with the VC to achieve that is critical. Building the working relationship with the VC is also key. VCs will put in formal punitive measures in their term sheets and agreements. Failure to meet expectations will result in VCs exercising these measures which can have drastic implications for the EN. This does not entail being agreeable to every decision or request by the VC. But necessitates that the EN be open, honest and transparent regarding all information that would enable VCs to make more informed decisions and encourage the open debate required to make mutual decisions.

7.4 Limitations of this research

The greatest limitation of this research was the limited data set. As detailed in chapter four. The greatest disadvantage of the case study method in the possible generalisation of the data gathered to a larger population (Saunders & Lewis, 2012). As a result, to produce more more vigorous, generalised and applicable findings, multiple case research design is used because propositions are more deeply based in diverse evidence. (Eisenhardt & Graebner, 2007; Yin, 2009). However, as finding willing participants proved very difficult given the considerable confidentiality challenges, extreme unwillingness, and significant timing constraints of VCs. This research only presented three cases of South African VC firms operated by relatively inexperienced VCs. As VCs improve funding and monitoring decisions through repetition (Bengtsson & Bernhardt, 2014a). By inference, the above the benefits are limited in these results. This has led to the under-representation of groups within the sample such as *en commandite* partnerships, other listed entities such as SPACs, and government or other captive firms. As well as the under-representation of relatively more experienced VCs. Thus, seriously weakening the researcher's ability to infer generalisations from the sample population

7.5 Suggestions for future research

Research that considers venture capital investment transactions from the EN's perspective is underrepresented (Drover, Wood & Fassin, 2014). With most research on

informal relational control in entrepreneurial contexts neglecting the perspective of ENs (Duffner, Schmid & Zimmermann, 2009). In exploring optimality through a cooperative rather than a competitive exchange perspective, this research could be enhanced by gathering insights from the EN's perspective by moving their perceptions into focus. By doing so, would enable VCs to better understand the reasons behind EN rejection of control mechanisms. Enabling VCs to apply control provisions that are acceptable to encouraging entrepreneurial and economic activity (Maxwell & Lévesque, 2011). Further improving their decision-making processes, resulting in investors feeling more confident in their assessment of VCs and likelihood of providing the necessary funding to VCs to be allocated to entrepreneurial enterprises Maxwell & Lévesque, 2011).

7.6 Chapter summary

Having presented the discussion of the results in terms of the research propositions and academic literature in the previous chapter. This chapter presented conclusion of the research. This chapter presented principal findings, implications for VCs and ENs, limitations of the research, and suggestions for future research.

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APPENDIX 1: Interview guideline

Interview Consent Form

Dear Participant

I am conducting research into the optimum level of control in venture capital investment decisions. Our interview is expected to last about an hour, and will help us understand from both the venture capitalist and entrepreneur's perspective what the optimum level of control is considered to be, what moderating factors are considered to influence the optimum level of control, and how to achieve the most optimal outcome. **Your participation is voluntary and you can withdraw at any time without penalty.** Of course, all data will be reported anonymously. If you have any concerns, please contact my supervisor or me. Our details are provided below.

Researcher: Myles Waldeck

Email: 16392711@mygibs.co.za

Cell: 082 469 1489

Research Supervisor: Dr Jonathan Marks

Email: marksj@gibs.co.za

Cell: 082 469 0104

Signature of participant: _____ **Date:** _____

Signature of researcher: _____ **Date:** _____

Interview Questionnaire

Name:

Date:

Venture Name:

Venture Capitalist:

Role in transaction:

Start time:

End time:

Thank you for agreeing to meet with me today. I really appreciate your time and input into this research.

The title of the research is 'The optimum level of control in venture capital'. The purpose of this research is to gain an appreciation on what is the optimum level of control in venture capital is. This research aims to:

- Explore what the optimum level of control is considered to be?
- Explore the moderating factors influencing the optimum level of control?
- Explore suggestions to achieve more optimal outcomes

I need to perform a successful research project to qualify to graduate for a MBA degree and I have selected a topic that not only explores my curiosity but will be beneficial to my post studies career ambitions. My MBA journey has reaffirmed a burning desire to be involved in active transactions combining deal making and direct management consultancy opportunities. Combine this with a continued fascination in the art of influence and how we make decisions resulted in the identification of an interesting concept to be explored.

The nature of this research and interview is both conversational and exploratory. I would like to encourage you to speak freely and be confident in the fact the information shared in this interview will be confidential and you will remain anonymous.

Before we start, let me tell you a bit about myself.

May I ask you to please sign the consent form and you can please confirm that you are happy for me to record the interview using an audio recording device?

Semi-structured interview questions and probes

The main questions the researcher will ask and probe for in order to collect data to explore what is the optimal level of control in venture capital investment decisions. As the data will be gathered by means of qualitative semi-structured interviews, question order may change during the interview process.

Questions
<p>Question 1: Briefly tell me about yourself?</p> <p>Probe:</p> <ul style="list-style-type: none"> • Age? • Background? • How & why you got into Venture Capital? • Time in the industry?
<p>Question 2: Tell me about your portfolio?</p> <p>Probe:</p> <ul style="list-style-type: none"> • Number of investments? • Funds committed? • Investment sizes? • Portfolio focus? • Investment philosophy? <ul style="list-style-type: none"> • Instrument used? <ul style="list-style-type: none"> • Common versus preferred? • Stake taken? • Management approach? <ul style="list-style-type: none"> • Level of active involvement?
<p>Question 3: What level of control do you require in your portfolio companies? And why?</p> <p>Probe:</p> <ul style="list-style-type: none"> • With whom does control sit? And why? <ul style="list-style-type: none"> • Entrepreneur or VC? • How do you allocate financial, board, voting, veto, liquidation and other control rights across your investment portfolio? And Why? <ul style="list-style-type: none"> • Standardised or transaction specific? • As implied in the financial transaction or separately? • Based on performance or non-performance? • What control mechanisms do you use? And why? <ul style="list-style-type: none"> • Modify management team? • Board representation? • Alter the compensation structure? • Transfer rights based on contractual covenants based on financial and non-financial performance measures? • Exercise liquidation rights? • Stage funding? • Governance and reporting? • How do you exert control? And Why? <ul style="list-style-type: none"> • Rules versus relationship based approach?

Question 4: How do transaction and entrepreneur characteristics affect your required level of control?

Probe:

- How do changes in transaction characteristics such as changes in investment size, performance risk affect your level of control required? And why?
- How do changes in entrepreneur characteristics such as changes experience, reputation, ability & agreeableness affect your level of control required? And why?

Question 5: What behavioural dimensions of entrepreneurs have the greatest effect on your perceptions of agreeableness (i.e. resistance to control)?

Probe:

- Coachability or receptiveness to change?
- Openness to new ideas or methods?
- Accuracy in the provision of timely and truthful information?
- Willingness to place reliance on others through delegation?
- Vulnerability through the disclosure of confidential information?
- Consistency between actions and promises?
- Confirmation of alignment between share values and objectives?
- Exhibits benevolence and concern for others?

Thank you for your value input and time, it's much appreciated. Should you like to receive an electronic copy of the research dissertation, one will be made available to you.

My contact details are provided should you have any further questions or insights.

Would it be fine with you if I contact you again if I need to clarify any information, ask additional questions, or have you member check the interview's finding conclusions?

APPENDIX 2 GIBS ETHICAL CLEARANCE FORM



Copyright Declaration:

Why must I complete this form?

1. You need to acknowledge that you are aware of the following conditions:
 - All rights regarding intellectual property produced by a university student vest in the University, i.e. the University holds the copyright of all research done at the university.
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