NONCONTRACTUAL GOVERNANCE STRATEGIES OF BUSINESS ANGELS IN THE POST-INVESTMENT VENTURE RELATIONSHIP

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Abstract

Andreas Fili: Noncontractual Governance Strategies of Business Angels in the Post-Investment Venture Relationship

Business angels fulfil an important economic role in society by getting involved in early-stage ventures. This dissertation aspires to advance our knowledge of the governance strategies used by business angels in the venture relationship, based on the idea that the choice of governance strategies depends on the individual venture but is also shaped by the strategies adopted by any business angel network (BAN) the business angel is part of.

Major findings are twofold. First, the analysis suggests that governance strategies are role-contingent. The role of the business angel vis-a-vis the venture changes, typically from outsider to insider, as the relationship transitions through different stages. Business angels should only use governance strategies that are perceived as legitimate for their role. Moreover, all strategies do not mix well and some may even neutralize each other when used together. The impact of the BAN on the action of the individual business angel is not straightforward: the formalization of a BAN will certainly restrict individual action, but, on the other hand, it seems that the BAN can also be useful for managing conflicts.

Second, results indicate that conceptualizing the long-term dynamic of the investor-venture relationship in terms of any single theoretical perspective, be it agency theory, procedural justice, or norm-based influence, is too simplistic. The utility of each theoretical perspective is role-contingent: a business angel in the outsider role is better understood with agency theory, whereas a business angel in the insider role is better understood with norm-based influence theory.

The empirical data on individual business angels comes mainly from 30 interviews with 21 business angels, and some supplementary data. The analysis of BANs is made differently and based on a different data set consisting of approximately 150 interviews with BAN members, civil servants, politicians, banks, accountants, and entrepreneurs.

Keywords: business angels, post-investment, relationship, governance, role contingency, mentoring, investor roles, venture
Preface and Acknowledgements

In the cloud we used to call cyberspace 10 years ago, there are approximately 37 slightly different versions of this \textit{kappa}. At least one of these versions is strewn with learned references to ancient Greek philosophers, \textit{références érudites} from the founding fathers of sociology, random thoughts on metaphysics, and a burning defense of social science vis-a-vis natural science. (Un)fortunately, this version did not survive the harsh reality of \textit{slutseminarium}. In spite of my best efforts, there may also be some errors somewhere. \textit{Any and all errors remain my own.}

Like the versions of kappa, there are a number of versions of acknowledgements. At least one of these versions includes almost every person I ever met, in an effort to chart how each interaction – positive and negative – nudged me, if ever so little, to become the person who authored this dissertation. Another version had an even grander ambition, with an evolutionary historical look at the 7 million years of humanity including such mind-boggling events as the great endeavors of our ancestors at the cave at Pinnacle Point in South Africa, who are thought to have spent the last ice age 195 000-164 000 years ago living off sea vegetation and whatever the sea swept ashore. They were shut in a cave eating only brainfood – was this maybe the ancient forerunner of modern day computer programmers, who allegedly work best shut in the basement with nothing but Jolt to drink?

I digress. Any historical exposé of acknowledgements would need to include my grandfather \textit{Giuseppe Fili}, who brought his family from a dangerous post-war Sicily to Argentina in the new world, where my father would study at the technical university of Cordoba to become an engineer, after graduation receiving a 6 month-scholarship for Volvo in Olofström, signing on for Volvo for yet some time, and eventually – 10 years later – meeting my mother through
a blind date arranged by mutual friends. It would necessarily also include my
dear grandfather Stig Wijkström, who provided an upbringing that enabled my
mother to choose a career out of passion rather than economic need. She
became a librarian, and although I was cautioned by the well-meaning adults of
Mora that too much reading may make you förläst, I spent a lot of time in the
library of Mora, more than most kids. Maybe I am förläst, after all.

In one of my favorite Borges novels, the reader is faced with the library
of Babel. On the shelves covering the walls of its infinite number of rooms
every conceivable book is found. Unlike that library, the constraints of time and
space that define this preface will force me to choose what to write, and whom
to thank.

In no particular order, I will start with the ones who were absolutely
crucial for the creation of this dissertation. All my dear business angels, thank you
for your time. This dissertation would never have become anything at all
without the time and effort spent by the business angels I have been able to
interview. I would also like to express my gratitude to the people that I
interviewed over the years spent in Småland: bankers, entrepreneurs, civil servants,
politicians, and all others. In fact, I would like to make an even grander statement.
In the name of all social science, I wish to thank all the people who allow us to study
them.

Next, I wish to express my gratitude to my work place. Institutionen för
Fastigheter och Byggande is one of the greatest work places I have ever known, with
a very friendly, apolitical and open atmosphere. Such an atmosphere is not the
work of a few individuals alone, but the result of the interaction of all. So thank
you to all the great people of FOB, both upstairs and downstairs.

Having thanked my respondents and colleagues, I wish to continue in a
more detailed manner, by starting from the beginning. In January 2006, nearly 9
years ago, out of the blue, I received a phone call from Björn Berggren, whom I
knew from Uppsala in the last years of the twentieth century, but had not
spoken to for the last five-six years. He asked me if I would be interested in becoming a PhD student at Kungliga Tekniska Högskolan, with him as supervisor. I have never once regretted saying yes. Thank you Björn, my great friend.

On one of my earliest visits to KTH, my old friend Krim Talia came along. He soon became associated to KTH and embroiled in a lot of the work for a few of the early years. We became part of a family of projects with many acronyms: KAFI and KITE encouraged NOVA to start NAFU, which later spawned or transformed into KOMDEMO, NOTT, NOVA VENTURES, TRINOVA, and ATRINOVA, with links to ROAF, SMAAF, and to some small extent even STOAF. Thank you to the people involved, in particular the tireless Göran Edsbäcker and the BAN architect Lennart Oblsson. Krim – we do not see each other as much today, but I remember our old friendship all the more clearly.

At this time, Björn was not yet associate professor and could not be my supervisor formally. Instead, one of my first days at KTH, we went to Professor Stellan Lundström. Stellan was very much in the news in those days, being interviewed by DN and SvD each week on the potential risk of a Swedish housing bubble, so I was a bit nervous meeting him IRL. Stellan took one long look at me and asked me something in his calm northern dialect, and then signed the papers. During the years to come, Stellan has showed great confidence in me, and I will always be grateful for it. During this initial time period, before Björn officially became my supervisor, a deep and abiding interest in a range of real estate topics awakened that is still there today.

Lars Silver was another one of the people who had migrated to KTH from Uppsala. He and Björn had been constant partners in watching Hammarby Football Club, in teaching, and in research, ever since they became PhD students in Uppsala in the late nineties. When I came to KTH, Lars quickly became very important for me as I struggled to make sense of how to balance
the demands of my scholarship providers, the needs of teaching, and the needs to make progress in my dissertation. Today, he is a Professor in Umeå, and we only see each other occasionally. Thank you Lars for all the advice over the years on everything from matters of organization to research. I have had great use of your thoughts many times.

My co-supervisors Professor Kent Eriksson and Jaan Grünberg. Kent, even though you are currently MIA at Stanford, I want to thank you for a number of inspiring conversations at decisive moments over the years. Jaan, thank you for two things. First, thank you for being my teacher in the Organization Theory course (back in 1997?). I had spent a year in France studying Sociology and Literature, realizing the great beauty and potential of social science, but it was not until I came back to Sweden and ended up in your course that I understood that the academic subject of Business Studies held that same promise of beauty and relevance. More recently, I wish to thank you for the way you have supervised this dissertation, your way of delicately balancing work and friendship in your role as co-supervisor.

I love teaching and today I am also the newly appointed program coordinator for our bachelor programs for the next four years. I also want to thank most of my students. Nearly all of them, but not quite. Thank you Professors Thomas Kalbro, Mats Wilhelsson and Hans Lind for believing in me over the years. When I mention teaching, I should thank the guys at IT Piloterna, my first real job after graduation. It was through their pedagogical method, and the endless teaching sessions that I held 10 a.m. to 4 p.m. each day for our customers, such as teaching all of SIDAs approximately 600 employees information retrieval and business intelligence, that I was able to find my own teaching style. *REPETITION IS THE MOTHER OF ALL KNOWLEDGE.*

This dissertation owes a great debt to all my present and former multidisciplinary colleagues at CEFIN and FOB for attending my seminars over the years, as well as conversations over coffee. Thank you Niklas Arvidsson, Tom

Through your multidisciplinary comments I have realized, over and over again, that many similar theoretical traditions needlessly exist in parallel with no communication between them. I hope to accomplish much integrative research, crossing the boundaries of disciplines. My partner in crime in teaching, Inga-Lill Söderberg. You are the only one with more books in your room than I have in mine. You inspire me every day, with your energy and optimistic creativity. Thank you also to Tina Karrbom Gustavsson for making the effort to provide intelligent last-minute input on the kappa. Last but not least, thank you very much to the fantastic Muriel Beser Hugosson that I came to know last year during one of those pedagogical KTH courses. We needed to produce a high-quality end-of-the-course-so-you’re-expected-to-submit-top-stuff protocol on rather a tight deadline, one that would be submitted to the merciless scrutiny of the ever watchful Khalid El Gaidi. We did it! Thank you Muriel, for both mentoring and merry laughter.

Eva Pettersson, Désirée Mathson Gavelin, Nadia Arman, Åsa Carlsson and Johanna Stellan. Thank you for simplifying my days at KTH immensely and giving me the opportunity to focus on what I (like to) do best.

Over the years, I have enjoyed useful advice from my old and loyal friends James Sallis, Susanne Åberg and Josef Pallas, all three at FEK (the Department of Business Studies, Uppsala University). Susanne, when we started undergraduate studies in 1992, who knew what we would do today? Moreover,
at FEK I was also given the opportunity to present some of the material that eventually ended up in here. Thank you to all attendants of that seminar for insightful comments. At SLU, there were Professor Christer Olofsson, Göran Lindström and Richard Ferguson. Thank you for making me feel so welcome in your circle, one of the foundational Swedish sites of knowledge on entrepreneurial finance. I benefit from this heritage still today.

Last but not least, I close by thanking my family and friends. Thank you mamma Monika Fili for passing on the greatest gift of all to me, the love of books. Without that love, I would be neither who or where I am today. Thank you pappa Francesco Fili, for your extremely high integrity, honed over 40 years in the large-scale multinational politico-industrial milieu of SKF and Ovako Steel. While your stories ultimately made me avoid becoming an engineer, I have benefited in many ways from your experiences and I like to think that I have inherited some of that Sicilian backbone. The blend of you both gave me the two best siblings I could ever hope for. Thank you Giovanni Fili and Maria Fili for always always always being there, together with your fantastic better halves Jeanette Fili and Daniel Johansson. Thank you. My extended family in Gothenburg: dearest Lilian Olténg, Johan Ekenberg and Rebecca Ekenberg. Thank you for having me as your guest, to drink quadruple meta-metas, to talk about life and go to the beautiful Gothenburg Opera, as well as to work on important sections of the dissertation text. I hope to always have new texts that need the quiet sunny heights of Nordhemsgatan 45 to progress.

Thank you to my godfather Ulf Wijkström, and dear Beatriz (a kindred spirit in our love of sociology), and to the great clan Wijkström in all parts of the world. Thank you to my father in law Olof Hallén for being such a wise and good person, full of a thousand colorful and insightful anecdotes of yore. I am also indebted to the large and wonderful Hallén and Kallberg families for taking me so fully into your embrace. I hope to continue having great debates on topics
high and low, and to see a little bit more of all my relatives now that the dissertation is at an end.

I also hope to once again see a lot more of my friends. You have shown great patience with the time demands of my dissertation, the way I have needed to shut myself away during periods of time. I hope that such periods are now behind us forever. Instead, the future is sunny and bright and full of loud electronica delivered on great sound systems, be it on Berghain, in Ibiza, in Amsterdam, at Kammakargatan, in Enhörna, in Lidingö, in Danderyd or elsewhere. You know who you are: Uffe, Maria, Pelle, Maja, Torkel, Markus, Becky, and Kevin. I owe a great debt of gratitude to my dear friends from my time at Svartmangatan. To brilliant physicist, mystic, humanist, aesthetic and one of my closest friends, Magnus Bergh, and to the equally brilliant Carl Caleman (yes the same Carl Caleman who has published in both Science and Nature): thank you both for many deep thoughts and cognitive explorations. To Linda Mattiasson, I am so happy that you are back from Norway. Talking to you means a lot to me. Mattias Pettersson, time to train... five times each day. Let’s go. Finally, Svartmangatan resident emeritus Martin Malmberg: my old friend, it is time to get together again.

Many of you ask me what I am going to do once this dissertation is finished. When I came to KTH that first day it was with a steadfast idea to get my PhD in three years, grab the diploma, get back out into consultancy and double my fee. Somewhere along the way, things happened. I taught a lot of courses and I did a lot of consultancy work for KTH in research projects not directly related to my dissertation, both common (and fun) distractions in the life of a doctoral student. In my personal life, for nearly the entire time, I have struggled with a still undiagnosed back/stomach ache that comes and goes for long time periods, during which I cannot sleep properly because of the pain. Sleep deprivation over prolonged periods of time is not conducive to abstract thinking, and my initial plans were somewhat delayed. There have been much
more pleasant reasons for delay also: I have had two GREAT kids (Virgil Francesco Olof Fili is now nearly seven years old and Valdemar Giovanni Ask Fili just turned three). My dear bonus son Samuel Hållen went from being an eight-year old to a young man about to turn 18 next summer, and well on his way to becoming a farmer at Jälla Gymnasium. Our Jack Russell dogs Asta and Eskil, siblings from the same litter, went from being two energetic puppies to becoming senior, well-behaved adult dogs who nearly never run away on 12-hour hunts anymore. Eskil now lives a life of luxury with dear uncles Erik Freudenthal and Åke Mångs, eating human food and sleeping in human beds, although at times he returns to us to detox on regular dog food and to hang out with best friend Asta again.

Maybe the most important reason for my change of heart came from the dawning realization that teaching is something that I really like, and that teaching might even be a great way of changing the world, student by student. I really like research as well, although I am still not very experienced. In my work, I can really shape my own work experience and I enjoy an immense degree of freedom to accompany the great responsibility I have for our students. I get to integrate my own research findings in my own teaching. I get to work with people I really like. Even though commuting by train sometimes feels extremely tedious when it’s late at night in winter Stockholm and all remaining trains have been cancelled, I have no plans on leaving KTH anytime soon…

In closing, I would like to thank my dear wife Elin Hållen. When I am with you I never feel alone. I dedicate this dissertation to you and our children.

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Introduction

High-growth entrepreneurial ventures play a key economic role in innovation-driven economies (cf. Global Entrepreneurship Monitor, 2012). They are vital for job creation (Henrekson & Johansson, 2010), but perhaps more important, they are crucial for innovation in the production process or in the product/service itself (Shane & Venkataraman, 2000). Owing to large cash flow needs, capital investments, and lengthy product development cycles, ventures depend upon externally generated resources (Barringer & Ireland, 2012). However, during the startup stage, the fledgling venture is exposed to the equity gap, which is defined as the difficulty of new firms to finance their operations (Mason & Harrison, 2003). This equity gap in funding was identified as early as 1930 (MacMillan, 1931; Murray, 1994). New firms typically have little or no collateral and a limited track record, which exclude them from traditional bank lending. Firms that are started in new industries, such as research-based, knowledge-intensive startups, are particularly vulnerable to the equity gap.

In their 2002 work, Lindström and Olofsson argued that the single most important actor supplying such resources for ventures in their early development is a private investor called the business angel (Wetzel, 1983). As a consequence, policymakers have tried to help mitigate the equity gap by simplifying or removing rules and other institutional factors for the business angel community. For instance, there have been co-investment schemes in which the government agency matches the money invested by a business angel. In some cases, this aid from the government has taken the form of changes in legislation; in others, it has been provided in the form of education and training in so called business angel academies (Mason, 2009; San José, Roure, & Aernoudt, 2005).
A business angel is a private investor who invests in unquoted firms in which there is no family connection (Harrison & Mason, 2008). First and foremost, business angels provide financial capital from their own fortune. Business angels invest their own money, from their own savings. This criterion separates business angels from professional venture capital (VC) firms, which manage funds consisting of capital provided by investors (cf. Sahlman, 1990). Second, the investments are made directly in unquoted firms. This separates business angels from other wealthy individuals who merely invest in firms through the stock market, with no personal contact. Third, business angels have no family connection to the firm. This third criterion is added to separate business angels from family firms, where investments may be guided by a family logic that is somewhat different from a business logic. The term love money investors is used to describe investors who invest in their own family firm where they often also work. A convincing argument has been put forward that the motives and forces involved in family firm investing are different from those involved in operating at a nonpersonal level of interaction and that business angels and love money investors should be studied separately (Riding, 2008).

The fortune of a business angel is often the result of a successful entrepreneurial career, and it is the experiential knowledge gained during this career that provides the human capital. Such knowledge transfer is especially important in areas where founders lack competence (Colombo & Grilli, 2010; Lindström & Olofsson, 2001). Business angels also provide social capital in two ways. First, they have access to extensive industry networks. Second, they signal legitimacy to stakeholders, in the same way as do VC investments (Colombo & Grilli, 2010) or public investments (Lerner, 1999).

By becoming involved in a venture after the initial investment, in the so-called post-investment relationship, the business angel contributes resources and adds value to the venture by performing various activities (Politis, 2008). To date (with a few exceptions), research on such post-investment business angel
activities has been of a descriptive nature. For instance, studies have reported that business angels often assume a position on the board and offer strategic advice concerning the ventures (Wetzel, 1983). However, boards differ in both roles and processes (Gabrielsson & Huse, 2002), and there can be substantial variations between different ways of giving and receiving advice (cf. Dalal & Bonaccio, 2010, for an overview). Studies on business angel activities need to accommodate such behavioral differences in a meaningful way.

From a practical point of view, learning more about the behaviors of business angels in their venture relationships may provide entrepreneurs with a better chance of developing meaningful relationships in the future—that is, they can understand business angel behavior better, and the financial, human, and social capital of the business angels can be used efficiently. As business angel behavior is explained in terms of new theory, business angels may profit by a renewed understanding of their own behavior. From a theoretical point of view, current business angel theory is unable to explain some of the observations of business angel behavior, in particular mentoring. These observations call for the generation of new theory, which is why the point of departure of the present dissertation is that there is a need for research of a qualitative nature, which is open to influences from other theoretical traditions and disciplines.

The focus of the present dissertation is on understanding the behavior of business angels in terms of governance strategies in the venture relationship. Governance strategies identified in earlier research on interfirm relationships include monitoring, incentive schemes, selection, and socialization (Wathne & Heide, 2000). Governance strategies are used by business angels to achieve coordination and control in the post-investment venture relationship. Coordination and control can be explained in terms of goal alignment. When two parties, such as an investor and an entrepreneur, enter a relationship, their respective actions need to be coordinated. Even though interests may be aligned, problems associated with coordination can emerge. Control, by
contrast, springs out of goal divergence between the two parties (Vlaar, Van Den Bosch, & Volberda, 2007a). Thus, as the post-investment relationship is characterized by cooperation, there is a need for coordination. When the relationship is characterized by competition, there is a need for control. One way to manage such coordination and control is through the use of explicit contracts (cf. Kelly & Hay, 2003). These contracts have an impact on the post-investment relationship. In the present dissertation, such explicit contracts are not analyzed.

Although the strategies used by business angels depend primarily on the individual venture relationship, there are external factors that affect relationships. Business angels are frequently connected to a business angel network (BAN). Such an organization could have procedures for managing ventures, which would constitute a major external factor affecting the way the individual business angel is able to act.

**Purpose of the Dissertation**

The purpose of this dissertation is to analyze the noncontractual governance strategies used by business angels for post-investment venture coordination and control, in relation to the individual venture relationship and the business angel network of the business angel.

**Outline**

The rest of the dissertation is structured as follows. In the next chapter, the characteristics, the organizations, and the investment process of business angels are described. An exposé of the theoretical perspectives hitherto used most often to study the post-investment relationship—rational choice, procedural justice, and norm-based influence—is presented in the third chapter. In the
fourth chapter, I provide a description of the methods used and a discussion of the methodological choices I made during the study. In the final chapter, the results and the conclusions of the dissertation are presented. Finally, a reprint of each of the five papers is provided in the Appendix.
Business Angel Research

Business Angel Characteristics

It is generally agreed that business angels, because of their anonymity, constitute an unknown population but most likely can be found in all countries, in one form or another (Van Osnabrugge & Robinson, 2000). Studies have indicated that the total size of business angel investments is larger than the size of investments made by VC firms in Sweden (Avdeitchikova, 2008), in the United Kingdom (Mason & Harrison, 2000), in Canada (Riding, 2005), and in the United States (Sohl, 2003). The total sum of all investments made by business angels is only slightly larger than the sum of investments made by VC firms, but the real difference is in the number of investments made by business angels.

Most studies on business angels focus on describing their characteristics (cf. Elmoznino Laufer, Svensson, Wennberg, & Berglund, 2014). The typical business angel is a well-educated man (many have graduate degrees and most are male) who finances firms anywhere within one day’s travel from home and expects to play an active role in the firms that are financed. Business angels undertake one to two investments per year that range between US$10,000 and US$500,000, with an average of approximately US$50,000. Although there are exceptions, investments are made in firms that are less than 5 years old and primarily in the sectors of manufacturing (industrial/commercial products or consumer products), energy/natural resources, services, and software (Hisrich, Peters, & Shepherd, 2005).

Empirical data on business angels have suggested that most fail to achieve a large return on their investments. Although angel investing seems to have a negative return for the most part (Shane, 2008), it does not seem to deter
business angels from continuing their investments in new ventures. One explanation for this finding may be that achieving financial returns is not the only rationale behind making angel investments. There is a strong nonfinancial element in the investment patterns of many business angels (Baty & Sommer, 2002; Sullivan & Miller, 1996). For instance, business angels state that they invest so as to give something back to the regional context from whence they came, as well as to become involved with the next generation of entrepreneurs. Being wealthy, they do not depend on a stable monthly revenue. As a consequence, they can wait for the right moment, combing various innovation sites, searching for that right venture. For this reason, they can invest in a wider range of firms, including some firms that would not attract a traditional investor. Although such firms may be less “investment-ready” (Mason & Harrison, 2004) at the time of the investment, they may realize some of their potential as time passes, thereby becoming attractive to VC firms.

In this capacity, business angels take risks that neither banks nor VC firms are willing to expose themselves to, and they generally adhere to an investment process that is characterized by the use of heuristics (Maxwell, Jeffrey, & Lévesque, 2011) as well as a high level of iteration between the different process steps. An important difference between VC firms and business angels is that business angels invest their own funds, which are limited. Therefore, one could say that when a business angel invests in a venture (in a post-investment relationship), there is no possibility of a refund. If the venture performs poorly, the business angel could try to sell the equity back to the venture founder. However, the founder, having invested a great deal of money in the venture a long time ago, seldom has any such funds. The second option is to offer the equity to another investor, but few want to buy equity in a startup firm that is not performing well (Mason & Harrison, 2002). In other words, there is no gain from defensive strategies. Thus, until the point where all hope is lost, the business angel is strongly committed to the relationship, and should be
expected to behave in such a way that the venture relationship fares as well as possible.

The Investment Process of Business Angels

In their 2007 study, Paul, Whittam, and Wyper described the investment process of business angels in terms of five stages: familiarization, screening, bargaining, managing, and harvesting. The process starts when business angels become aware of a potential investment opportunity and ends when they sell their share of the company.

In figure 1, the investment process of business angels is described. The first stage is called familiarization. It occurs when the business angel is made aware of the existence of a particular venture. For a formal VC firm, this is often described as receiving a large number of business plans/prospects in a deal flow, in the stage known as deal origination. According to Paul et al. (2007), deals, however, seldom appear out of the blue for business angels. Instead, the potential investments are often ventures that originate in the network around the business angel (through business associates, BANs, and investment syndicates); therefore, the process is more aptly described as two parties who informally familiarize themselves with each other. Familiarization involves first learning about the opportunity and subsequently meeting the entrepreneur. The key factors for assessing the opportunity are scrutinized immediately. However, angels may be prepared to make exceptions and examine proposals that do not match their normal preferences if someone they trust has provided them with the referral. Not only are key factors of the business idea important but also the way in which the entrepreneurs come across to the angels as they present themselves.
The second stage consists of more structured assessments. This stage is broken down into two major screening activities: initial screening and detailed screening. The initial screening includes further meetings with the entrepreneur, a thorough study of the business plan, and the use of the business angel’s own networks to check the background of the entrepreneur, as well as an analysis of the possible ways in which the business angel can contribute to the development of the business in addition to the provision of financial capital. Paul et al. (2007) noted that during the screening stage, a business angel would, in some cases, be overcome with a feeling of commitment toward an entrepreneur, even though there would usually remain a number of concerns to be ironed out before any investment could be made. Such commitment would typically lead to heavy involvement from the business angel so as to speed up the resolution of remaining concerns, resulting in a number of amendments to the original business plan (most often in the areas of marketing and finance), particularly for startups.

The bargaining stage then follows. During this stage, the due diligence is completed. It may be an informal activity rather than the formal procedure frequently performed within formal VC. The most important part of this stage involves the negotiations carried out regarding the value of financial investment in equity terms. Reaching a final agreement is difficult. Justice is of central concern during the bargaining stage because feelings of injustice will haunt the working relationship even from the start (directly after investment). Considerations of follow-up rounds of financing are also made during this stage; however, they may not be included in the written contract. The bargaining stage concludes with a formal written agreement between the entrepreneurs and the angels.

The last two stages are managing and harvesting. The word managing is another term for the post-investment relationship. There are a number of empirical studies on business angels that focus on this post-investment
involvement. Many of these have studied the behaviors of business angels (for a review, see Politis, 2008, or Fili & Grünberg, in press, in this volume). Repeatedly, such studies have shown that business angels assume a position on the board of directors, act as a sounding board, and—although less often—perform operative functions. Sadly, few of those studies have actually sought to penetrate the meaning and content of these activities in individual cases. The behavior of one board member can be very different from that of another (Gabrielsson, 2003). One chairperson of the board can be oriented toward consensus, whereas another can adopt an authoritarian approach. Thus, even though there are many time studies, specifying whether business angels speak on the phone with members of firms, visit firms in person, attend board meetings, and so on, there is a gap in the knowledge on business angels, in that these studies do not really capture the full depth of a relationship.

The last stage to describe is harvesting. An elusive stage of the investment process, harvesting is commonly referred to as making an exit. According to Cumming and MacIntosh (2003), exits made by venture investors can be described in terms of partial or full exits and defined in terms of five different exit vehicles. The classic successful exit vehicle is the initial public offering (IPO). However, the other successful exit vehicle of trade sale has become an increasingly attractive alternative. In a trade sale, the venture is sold to a business competitor or to another investor. An IPO and a trade sale are both relatively full exits, whereas there are other exits that are merely partial and not as successful. (For an overview and a discussion of the signaling value of partial exits, see Cumming & MacIntosh.) Paul et al. (2007) reported that the business angels in their research had no clear preference about how to make their exits; however, the business angels believed that their exits would most likely be through trade sales rather than through IPOs.

The exit is a problematic event. The existence of a second equity gap, occurring around the time of exit for the business angel, has been suggested by
Murray (1994). In his analysis, there are difficulties for business angels in realizing a profitable exit by divesting their equity to VC firms. The idea that business angels would be able to realize an exit by selling their entire stock to venture capitalists has been denounced as unrealistic. Instead of buying the shares of the business angel, most venture capitalists seem to prefer injecting their capital investment into the development of the venture through the issuance of new equity. This finding implies that the exit of the business angel occurs much later in the development of the venture and is inextricably linked to the exit of the VC firm. The discussion is still very much alive, and the second equity gap has been recently attributed to the overvaluations of startups by business angels that lead to inflated stock, deterring VC firms from buying equity (Tate, 2013).

The majority of scholarly research on venture capital and business angel investment is focused on pre-investment activities, in particular screening, due diligence and startup valuation, and bargaining/contract design. For instance, as noted by Fili and Grünberg (in press), Van Osnabrugge and Robinson (2000) discussed the complex, relational dynamics of the 5-to-10-yearlong business angel—venture post-investment relationship in a 10-page chapter in their several-hundred-page definitive guide to angel investing. Still, it is well known from research on business angels that business angels themselves devote more attention to post-investment aspects of venture investment (Lindström & Olofsson, 2001; Paul et al., 2007). As stated earlier, the investment process of VC firms is conducted in a more formal way than the investment process of business angels. However, having said this, there are organizational forms among business angels that make them more reminiscent of VC firms.
Business Angel Clubs, Syndicates, and Networks

A continuum ranging from the ideal individual business angel to the formal VC fund exists in the various cooperative organizational forms that business angels use. According to Van Osnabrugge & Robinson (2000), there is a venture capital continuum, that ranges from the informal business angel, via the semi-formal angel syndicate, to the formal VC firm (p. 44).

Stereotypically, business angels work independently or as part of a small group of close friends. However, business angels can also form part of a more or less organized group of business angels (May, 2002), and previous research has reported that many do (Hisrich et al., 2005). These groups of business angels are commonly referred to as BANs. There is some confusion in the terminology concerning angel organizations (Sohl & Hill, 2007). In addition to the term BANs, terms such as syndicates (Van Osnabrugge & Robinson, 2000), groups (Sohl & Hill, 2007), clubs (May, 2002), and alliances (Sohl, 1999) have all been used. In works by Mason and Harrison (2008) and by Paul et al. (2007), the term syndicate is used in parallel to the term BAN, implying that they have different meanings. Sohl and Hill (2007) suggested that the terms syndicate and group are synonymous, and in their usage, these terms denote “a formal collection of angel investors that meet regularly to examine potential investment opportunities” (p. 209). The investment platform AngelList (2014) stated that “a syndicate allows investors to co-invest with other notable investors. People who back a notable investor’s syndicate commit to invest in their future deals, and agree to pay them carry.” In their review study, published almost 20 years ago, Mason and Harrison (1997) noted that BANs act as arenas where business angels can take part in investment proposals in full anonymity but that BANs are in no way involved in negotiating or structuring the deal. However, BANs today seem to act in a much more coordinated fashion. Whereas individual
angels can sometimes listen to investment proposals and then decide whether to invest individually, a structured angel group acts in a coordinated fashion.

According to Shane (2008), angel networks range from highly informal networks to formal angel funds. Typically, an informal network is created when one angel develops a proposal for investing in a venture and then approaches some other angels with whom there is a business (e.g., a co-investment) or a personal history. The lead investor, the one who proposed the deal to the others, assumes the responsibility of managing the relationship with the entrepreneur; the others typically sit back and become relatively passive investors until there is an urgent need for some specialized knowledge (cf. Lindström & Olofsson, 2001). Business angel funds are formal organizations that are very similar to VC funds in the way they are set up, except that the capital being invested in portfolio firms comes from the business angels involved in the fund (Shane, 2008).

Organization in a network gives rise to efficiencies in the investment process. A network of angels means a larger number of angels who can share the workload in screening, due diligence, contract formulation, and management and harvest of the portfolio firms. Paul and Whittam (2010) reported that Scottish business angel syndicates rely on using gatekeepers to manage both familiarization and screening to a large extent. In addition to having a larger number of people to share the work, a network also means having access to the diversified pool of experience of the network members. A network is also publicly known in a way that an individual business angel seldom is. These three differences have a number of important implications. Being known to a larger public means gaining access to a larger deal flow, which is extremely important because the size and the quality of the deal flow set the limits for everything else in the business angel investment process. This increased deal flow can be handled by the larger number of members in a network. Thus, a larger number of investments can be screened, discarded, managed, and harvested, and these
portfolio firms can have a much more diverse industry background. A larger number of business angels gain access to a larger deal flow, share the workload, and have a larger source of experiential knowledge to tap.

Table 1
A Typology of Business Angel Networks (BANs)

<table>
<thead>
<tr>
<th>Typology of BANs</th>
<th>Informal organization</th>
<th>Formal organization</th>
</tr>
</thead>
<tbody>
<tr>
<td>Many angels</td>
<td>Information networks</td>
<td>Business angel funds</td>
</tr>
<tr>
<td>Few angels</td>
<td>Classic business angels</td>
<td>Investment clubs</td>
</tr>
</tbody>
</table>

As shown in Table 1, a description of various cooperative forms between business angels could start with the few and informal, and then move toward more complex forms of the formal organization involving many angels. In the present context, different forms of organization exist between business angels, with an important difference between business angels who simply convene to access a mutual deal flow (information networks) and those who co-invest. (For a more in-depth discussion [in Swedish], see Silver, 2008).

Another degree of formalization is added when a BAN acquires a fund structure, where the members pool their capital into a fund that exists independently of individual investments. Yet another development occurs when professional management, in the form of employees, is added (Shane, 2008). Typically, the way that angels are organized has an impact on each step in the investment process; that is, individual angels have an informal approach, whereas the larger the cooperative form, the more formal the investment process so as to coordinate all members.

In summary, although such cooperation means less power and opportunity for active involvement for each individual business angel, several positive professionalization effects exist, such as pooling of capital (for larger deals, for more rounds of funding, and for a larger number of deals),
diversification of investment risks, and access to needed expertise in the network. Thus, syndicated deals are generally more professional than the deals made by individual business angels (Van Osnabrugge & Robinson, 2000). Some of the stages of the investment process are made more efficient, and there are synergies in terms of handling information, risk diversification, and division of labor. However, in order to achieve cooperation, both parties must be ready to make compromises.
Theoretical Perspectives on the Post-Investment Relationship

Three Relationship Perspectives

A number of theoretical perspectives have been used to describe the venture relationship, not only within the larger stream of research found in the VC literature but also within the smaller stream of research in the business angel literature. A historical reading yields three major perspectives, used over time. These perspectives are rational choice theory, organizational justice, and norm-based influence (see Table 2).

Table 2
Theoretical Perspectives on Coordination in the Venture Relationship

<table>
<thead>
<tr>
<th>Perspective</th>
<th>Theories</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rational choice theory</td>
<td>Agency theory, game theory</td>
</tr>
<tr>
<td>Organizational justice</td>
<td>Procedural justice, interpersonal justice</td>
</tr>
<tr>
<td>Norm-based influence</td>
<td>Leadership, mentoring, socialization</td>
</tr>
</tbody>
</table>

For each perspective, I note the theories that have been used to study the venture relationship. All three perspectives make certain predictions, but there is no single perspective or theory that is able to explain all the dynamics of the venture relationship. Each of them has a number of important basic assumptions about how organizations and people function.
Two Ideal Views of the Firm

In their 2003 study, Koza and Thoenig argued that there are two ideal types of firms that can be used to distinguish different theories (see Table 3). The ideal types are defined in four constructs. The first construct, action arena, describes the type of behavior that actors within the firm exhibit, ranging from strategic (self-interested) to (altruistic) behavior motivated by identification. The second construct, purpose, describes the purpose of organizational practice. In some firms, (instrumental) action may be directed at achieving goals, whereas in others, action may be expressive, “a source of social integration for its members” (Koza & Thoenig, p. 1226).

The third construct, payoff matrix, describes how preferences are modeled and defined. One view states that preferences are defined as exogenous (i.e., they are brought into the organization by individuals) and static. By contrast, the other view states that preferences are endogenous and susceptible to influence. According to this view, preferences are plastic and can be changed. The fourth and last construct, levers, describes the source of control in each view. It can range from one extreme where incentives are relied on to motivate people to the other extreme where normative order and ideology are used to achieve control. In addition, Koza and Thoenig maintained that “while these two extremes define analytically distinct forms, the firms in which individuals actually maintain membership, and which are observable, may be described as more or less strategically behavioral or morally community-like” (p. 1226).
Table 3
Two Views of the Firm

<table>
<thead>
<tr>
<th>Strategic view</th>
<th>Action arena</th>
<th>Purpose</th>
<th>Payoff matrix</th>
<th>Levers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Normative view</td>
<td>Strategic behavior</td>
<td>Instrumental</td>
<td>Exogenous</td>
<td>Incentives</td>
</tr>
<tr>
<td></td>
<td>Identification/normative order</td>
<td>Expressive/institutional</td>
<td>Endogenous</td>
<td>Ideology/social organization</td>
</tr>
</tbody>
</table>


I shall propose that the theoretical perspectives used to study the post-investment relationship can be understood in terms of the two views proposed by Koza and Thoenig (2003). These theoretical perspectives, beginning with rational choice, are examined more closely in the following subsections.

**Rational choice**

The oldest theoretical foundation used to model investor relationships is rational choice theory. Individuals have preferences, and by satisfying these preferences, they derive utility. Rational choice states that individuals will act in a rational manner in such a way that their utility is maximized. Within the rational choice tradition, there are two major models of investor-venture relationships: agency theory and game theory.

Agency theory states that actor A—called the principal—wants to accomplish a certain task. To do so, the principal must find an agent to carry out the task. In the present case, the principal is an investor who is looking to earn money, and the agent is either the entrepreneur in a venture (the owner-manager) or simply a hired manager. The investor becomes the co-owner of a
firm, where the manager has been given the mission to manage the firm. Because the owner and the investor are both rational and want to maximize utility, it follows that they both want to gain from their involvement in the firm. Jensen and Meckling (1976) colorfully described this situation as follows:

If a wholly owned firm is managed by the owner, he will make operating decisions which maximize his utility. These decisions will involve not only the benefits he derives from pecuniary returns but also the utility generated by various non-pecuniary aspects of his entrepreneurial activities such as the physical appointments of the office, the attractiveness of the secretarial staff, the level of employee discipline, the kind and amount of charitable contributions, personal relations (“love,” “respect,” etc.) with employees, a larger than optimal computer to play with, purchase of production inputs from friends, etc. . . .

If the owner-manager sells equity claims on the corporation which are identical to his (i.e., share proportionately in the profits of the firm and have limited liability), agency costs will be generated by the divergence between his interest and those of the outside shareholders, since he will then bear only a fraction of the costs of any non-pecuniary benefits he takes out in maximizing his own utility. (p. 312)

The modeling of the two actors shows that the agent maximizes utility by acting in self-interest, giving rise to the agency cost known as moral hazard, where the agent enjoys the utility without bearing all the cost. Moral hazard can be counteracted through instituting controls on the agent’s process or output (Ross, 1973). In the context of venture relationships, moral hazard predicts that once the venture has received funding, it will not make use of these resources in the way that the investor had hoped, such as growing in accordance with expectations. The VC firm tries to mitigate this problem by monitoring, staging
the deal, and using legal contracts (Storey & Greene, 2010, p. 355). Because of
the potential for engaging in moral hazard, agency relationships attract precisely
those people who wish to engage in moral hazard by maximizing their own
utility at the expense of the principal. The mechanism for attracting precisely the
wrong people in such a way is called adverse selection. Strategies for handling
adverse selection are employed before investing in the venture, and include due
diligence and syndication. Whereas due diligence aims to identify adverse
selection and to find ways to avoid investing in bad ventures, syndication simply
means sharing the risk of adverse selection with other investors.

The other model for investor–investee relationships that belongs to the
rational choice tradition is game theory, and particularly the prisoner’s dilemma.
Agency theory describes a zero-sum game, where the gain of the agent is the
loss of the principal and vice versa, and the collective gain to both actors is
static. This means that in the agency perspective, cooperation does not increase
the collective utility. By contrast, the prisoner’s dilemma is a game theoretical
model where collective utility is dynamic; that is, cooperation increases collective
utility. However, it is only when both actors cooperate that the highest rewards
can be received. In game theory, players are assumed to be rational utility-
maximizing actors who play to optimize their total utility based on the
information they have.

Even though the rewards are the highest when both actors cooperate
with one another, the overwhelming risk and the large cost of being betrayed
deter them from trying to cooperate. Instead, both actors have an incentive to
focus on developing their own self-interest. Cable and Shane (1997) described
this dilemma as follows: “The essence of the dilemma is that each individual
actor has an incentive to act according to competitive, narrow self-interest even
though all actors are collectively better off (i.e., receive higher rewards) if they
cooperate” (p. 145).
In the prisoner’s dilemma, the potential for moral hazard is the same on the part of the venture as on the investor side. The investor and the investee each must make the following choice: cooperate with or defect from the other player. In game theory, there is a great difference between single games and repeated games. In repeated games, the optimal strategy for players can be to cooperate: When the payoff is added over all repeated games, it is more profitable to cooperate than to defect, even though such cooperation can lead to lower payoffs in the short run. Because there is only the short run in single games and end games, players maximize their utility. Thus, a key component to understanding the dilemma lies in the time perspective; that is, players must compare the certain short-term gains from defection with the more uncertain long-term gains from cooperation.

Rational choice theories model an interaction between rational actors who try to maximize their utility through a maximum distribution of some unit for utility (money) based on their preexisting, exogenous preferences. However, empirical results indicated that the utility of some individuals would not be maximal even when they received a maximal distribution. Although they stood to gain from it, they would argue that a certain distribution was not fair or equitable. Observations such as these gave rise to the study of organizational justice.

Organizational Justice

Organizational justice arose as a field of study—initially within the study of distributive justice, and later, within the study of procedural justice. Distributive justice focused on the distribution of resources, or a fair outcome of a decision. Equity theory states that a fair distribution of rewards is one that is based on the contribution by each individual. However, in studies where respondents were asked to report their experiences of unfair treatment, respondents tended to
focus not on the outcome or distribution but rather on the way, or the manner, in which they had been treated during the distribution process (Tyler, 2000). Therefore, Thibaut and Walker (1975) argued for the merits of focusing on procedural justice.

The basic tenet of procedural justice is that actors’ perception of the outcome of a decision as fair is based on not only the actual outcome of the decision but also the decision-making process (Tyler, 2000). In other words, even though the distribution of utility may not be favorable, it is considered satisfactory as long as the process is perceived to be fair. For example, voting may not always result in the election of politicians for whom one has personally voted, but the procedure is fair, and, therefore, one accepts the results.

In the classic conception of a fair procedure, there are four elements (Tyler, 2000): the extent to which individuals can make their voices heard and participate in the process, the extent to which the forum is neutral, the extent to which authorities are trustworthy, and the extent to which individuals are treated respectfully. There has been a shift from an exclusive focus on decision making toward more attention on the interpersonal aspects of interaction (Tyler & Blader, 2003). Researchers have argued that interactional justice may be conceived as a third, separate dimension of justice (Bies & Moag, 1986; Bies & Shapiro, 1987; Bies, Shapiro, & Cummings, 1988). In fact, Tyler and De Cremer (2005) concurred that the way in which individuals are treated during interactions was experienced as distinct from the decision-making procedure.

Greenberg (1993) argued that interactional justice may be conceived in two dimensions, the purely interpersonal and the informational. The interpersonal dimension deals with the classic interactional elements of respect and dignity, whereas the informational dimension deals with truthfulness, adequacy of explanation, and justification. In his 2001 study, Colquitt noted that informational justice creates “a sense of inclusion in key decisions” (pp. 390–391).
Procedural justice has also been described in terms of four components (Tyler & Blader, 2003): the formal quality of decision-making processes, the informal quality of decision-making processes, the formal quality of treatment, and the informal quality of treatment. This reformulation would presumably include interactional justice aspects as well. For simplicity purposes, reference is made to procedural justice in the following paragraphs, although at times the interactional component may be very strong.

Procedural justice has been studied in many settings—for example, in specific experiences of contact between citizens and legal authorities (Thibaut & Walker, 1975), in the public perception of authorities’ fairness in general (Tyler, 1988), in the organizational context of leader–follower interaction (Tyler & De Cremer, 2005), in cooperative alliances (Luo, 2005), and in investor–venture relationships (Sapienza & Korsgaard, 1996). When parties entering an agreement perceive that the procedures for entering the agreement are just, they will adhere to the agreement longer (Pruitt, Peirce, McGillicuddy, Welton, & Castrianno, 1993; Pruitt, Peirce, Zubek, Welton, & Nochajski, 1990). Luo (2005) found that cooperative alliances in which both parties share perceptions of a high level of procedural justice—as evidenced in the way that alliance contracts are perceived by the boundary spanners in each organization—would perform better.

In their 2005 study, Tyler and De Cremer stated that “the widely used term ‘transparency’ captures a general sense of procedures that have this quality, being made based upon clearly stated rules, consistently applied” (p. 542). Transparency is indeed the core of the classic formulation of procedural justice. However, in a relational setting, procedural justice focuses on the ongoing interaction between the parties, that is, the interactional component. In their study of investor–venture relationships from a procedural justice perspective, Sapienza and Korsgaard (1996) did not distinguish between the procedural and interactional components. They instead focused on two parameters: the extent to which entrepreneurs provided timely feedback to investors and the influence
of investors on decision making. They concluded that these factors are particularly important to the relationship.

**Norm-Based Influence**

The term *norm-based influence* is a collective term used to describe all the ways that individuals can be coordinated and controlled through ideological means. Closely related terms include normative control (Barley, Meyer & Gash, 1988; Barley & Kunda, 1992) or clan control (Ouchi, 1979). I have chosen to use the term norm-based influence instead, as it includes not only control but also coordination. Through this kind of influence, the individuals are made to want to behave in accordance with a particular idea or norm. Terms that capture somewhat different aspects of this complex phenomenon include *different value-based leadership styles* (cf. Hunt, 1991), *organizational culture* (Schein, 1992), *socialization* (Van Maanen & Schein 1977), and *mentoring* (Kram, 1985).

To my knowledge, this perspective is the one least often used until now, and it is only mentoring that has been studied in investor-venture relationships. However, leadership is an even more illustrative example of the norm-based perspective. Therefore, in this subsection, I take a closer look at transformational leadership as an example of normative influence and briefly comment on mentoring and socialization in closing.

Transactional leadership includes exchanging rewards for employee action. However, Burns (1978) identified transformational leadership as transcending such transactional resource exchange. Instead, transformational leadership focuses on higher-order intrinsic needs (Judge & Piccolo, 2004). Followers are inspired to go beyond their own self-interests for a collective purpose (Howell & Avolio, 1993), through a leadership that is based more on trust and commitment than on contracts (Jung & Avolio, 1999). Transformational leadership is based on three separate leadership components:
inspirational/idealized influence, individualized consideration, and intellectual stimulation (Bass, 1999, p. 20). In his 1999 study, Bass defined these three components as follows:

*Idealized influence* and *inspirational leadership* are displayed when the leader envisions a desirable future, articulates how it can be reached, sets an example to be followed, sets high standards of performance, and shows determination and confidence. Followers want to identify with such leadership. *Intellectual stimulation* is displayed when the leader helps followers to become more innovative and creative. *Individualized consideration* is displayed when leaders pay attention to the developmental needs of followers and support and coach the development of their followers. The leaders delegate assignments as opportunities for growth. (p. 11)

Even though the three leadership components are universal, the way they are expressed in each particular setting is contingent on the “prototypical expectations” (Antonakis, Avolio, & Sivasubramaniam, 2003, p. 269) of the leaders and the followers in that setting (House & Aditya, 1997).

Charisma/inspirational-idealized influence accounts for approximately 65% of the response variance in transformational leadership studies (Avolio & Bass, 1988), not only providing followers with an energizing purpose and a role model for ethical conduct but also building identification with the leader and the vision articulated by the leader (Avolio, Bass, & Jung, 1999). Followers are personally committed and motivated through intrinsic rewards (self-expression, self-worth, self-consistency); by contrast, extrinsic rewards are de-emphasized (Shamir, House, & Arthur, 1993).

Intellectual stimulation is about finding new approaches to old problems (Seltzer & Bass, 1990). Followers are encouraged to rethink and reexamine

Individualized consideration is the degree of attention and support given to individual followers (Bycio, Hackett, & Allen, 1995). It measures the extent to which followers perceive that they are being treated as individuals by the leader rather than as part of a group (Tejeda, Scandura, & Pillai, 2001). It also “refers to leader behavior that contributes to follower satisfaction by advising, supporting, and paying attention to the individual needs of followers, and thus allowing them to develop and self-actualize” (Antonakis et al., 2003, p. 265). Individualized consideration is closely related to the classic definition of mentoring (cf. Scandura & Schriesheim, 1994). In its most basic form, the mentor provides career and psychosocial functions to the protégé (Kram, 1985). Career functions include coaching and sponsoring protégé advancement in job promotions, whereas psychosocial functions are aimed at developing the personality of the protégé by enhancing self-worth and self-efficacy, and they are, by necessity, based on deep interpersonal trust and intimacy (Ragins & Kram, 2007). Role modeling is such an essential aspect of mentoring (Haggard, Dougherty, Turban, & Wilbanks, 2011) that it has been singled out as a possible third function (Scandura, 1992). In the mentor–protégé relationship, the protégé wants to emulate the mentor (Wanberg, Welsh, & Hezlett, 2003). Thus, the values and opinions of the mentor are very important to the protégé, and in some ways, the protégé sees the mentor as a role model.

Socialization means acquiring a cultural perspective through an immersive learning process. By becoming a member of a certain cultural setting, an individual acquires social knowledge and the skills necessary for that setting. In particular, socialization means learning what perspectives and behaviors are desirable and what ones are not (Van Maanen & Schein, 1977). In the interorganizational setting, socialization has not been studied as often as within
organizations (Cousins, Lawson, & Squire, 2008). However, research has indicated that interorganizational interaction is just as infused with socialization as is intraorganizational interaction (Ring & Van de Ven, 1994). Thus, leadership, mentoring, and socialization all include the acquisition of behavioral norms, albeit in somewhat different ways, and have a bearing on the business angel post-investment venture relationship.

**Discussion of the Theoretical Perspectives**

In the previous section, three major perspectives were presented that have been used historically to understand the post-investment relationship. In Table 4, they are compared in terms of the dimensions previously identified by Koza and Thoenig (2003).

<table>
<thead>
<tr>
<th></th>
<th>Purpose of Venture and Business Angel</th>
<th>Preferences of Venture and Business Angel</th>
<th>Governance Mode of Business Angel</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Rational Choice</strong></td>
<td>Distributive</td>
<td>Exogenous</td>
<td>Extrinsic Incentives</td>
</tr>
<tr>
<td><strong>Theory</strong></td>
<td>Maximalisation</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Organizational</strong></td>
<td>Procedural and</td>
<td>Exogenous</td>
<td>Fair Procedures</td>
</tr>
<tr>
<td><strong>Justice</strong></td>
<td>Interactional</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Norm-Based</strong></td>
<td>Expressive</td>
<td>Endogenous</td>
<td>Ideology</td>
</tr>
<tr>
<td><strong>Influence</strong></td>
<td>Maximalisation</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

In Table 4, differences can be discerned among the three theoretical perspectives. One such difference involves rational choice. Rational choice theories exemplify the extreme strategic view, where actors behave so as to
maximize their distribution according to exogenous preferences. Because preferences are given, the only way for the business angel to influence the action of the venture is through a well-designed structure of incentives. The rational choice perspective is at the core of traditional financial theory.

Therefore, when Sapienza and Korsgaard (1996) published their study on procedural justice in venture investments, it stood out as something quite unique in its focus on justice and process instead of structure and control. Here the purpose is no longer to maximize distribution but to ensure that the best procedure is identified and adhered to. However, I argue that procedural justice is also based on an assumption that preferences are exogenous. In procedural justice, efforts are aimed at identifying existing preferences and designing procedures in such a way that individuals perceive them as fair. If preferences were assumed to be endogenous, efforts would instead be directed at changing the preferences of individuals, such that they would start liking the procedures. Thus, even though rational choice theories and procedural justice may seem very different, they all assume that the preferences of actors are exogenous in the short term. In procedural justice, the governance mode of the business angel is not restricted to incentives. Instead, when the procedures are perceived as fair, this perception evokes a response that is more ideological in nature.

This assumption is not shared by the norm-based influence perspective. It is instead assumed that the actors involved in a relationship can—and in most cases will—influence each other’s motivations and goals; that is, preferences are endogenous to the relationship. Theoretical perspectives that take an endogenous view on preferences have their origins in sociology, psychology, or organization theory. Thus, goals can become congruent through changes in preferences that occur unilaterally or mutually; over time, initially incongruent values are turned into shared values. Here, as the preferences of the venture are influenced by the business angel, the purpose of the venture is a question of maximizing the expression of the self rather than obtaining a maximal
distribution of money. Thus, this governance mode is purely ideological in nature.

In conclusion, there exist studies on the venture relationship that offer mixed evidence for all three theoretical perspectives in the investor–venture setting. This lack of consensus in the literature was something that would have a strong influence on the way my research eventually turned out.
Method

_Oskarshamn: the Emergence of my Research Problems_

I started out nearly 8 years ago as part of a project team involved in regional development. My own project sprung out of a larger research effort at Kungliga Tekniska Högskolan (KTH) that was being funded by the Swedish Agency for Economic and Regional Growth (now called Tillväxtverket, but at the time called NUTEK). This effort focused on exploring the third role of universities: how KTH and other universities could participate in the development of society (cf. Srinivas & Viljamaa, 2006). Together with primarily my supervisor, I spent much of the next 3 years in a municipality in Småland, and after that, I spent another 3 years in the same region, although this time in the neighboring municipalities, working on a project funded by the European Union (EU). Both projects focused on entrepreneurial finance and involved a lot of interviewing as well as some activities aimed at stimulating local and regional business development. These projects were documented in the form of four project reports, later published as KTH reports (Berggren & Fili, 2013a, 2013b, 2013c; Fili, 2013).

My colleague and I conducted about 150 interviews during the period from 2006 through 2011. We performed the majority of them while working as a team of two researchers, with one researcher asking the questions and the other taking extensive notes. With very few exceptions, the interviews were always recorded on audiotape, but only a few of them were ever transcribed. Instead, we relied on our extensive notes, and used the tapes to check for accuracy where our notes lacked the necessary degree of detail.
Initially, I had the idea of using this massive amount of data. However, the project had a character that was very similar to that of action research. At least to me, it appeared that the subject–object divide was not entirely clear; I provided input to some important discussions leading to decision-making that I would also be expected to study. Prior to my recruitment, the action research character of the project had been both praised and criticized by Professor Dick Ramström, an external evaluator who had been selected to evaluate the project (cf. Edsäterkö, 2006). I felt that I was not experienced enough to balance the dual role I thought would be necessary to make use of action research methods successfully.

Instead, I used the interview material from the regional projects, together with the archival data that we digested over the years, the reports we produced, the reactions we had from local actors, the dynamics internal to the municipalities themselves, the dynamics external to the region (macroeconomic development, mergers and acquisitions by large firms external to the region, etc.), and the recurring conversations with the steering committees (local politicians, local public servants, local savings banks) as a multifaceted, qualitative—maybe even to some degree intuitive—understanding of the everyday reality of small and medium-sized enterprises (SMEs) in the region. I brought this knowledge with me when I delved into the literature, and it helped me find and formulate my research questions. In the end, this material partly survived and became the basis for the last paper in this dissertation, the one describing BANs.

One of the other individuals connected to the KTH research projects had been responsible for setting up a BAN in Norrtälje, and during the years we spent in Småland, he co-founded another BAN. During the past 2 years, after the completion of the projects in Småland, this individual has been involved in co-founding yet another BAN, this time in Stockholm. I was able to observe these activities to some extent, and study his methodology closely during
lectures and in the literature (Ohlsson, 2006). Traveling together, we had ample time to talk about business angel investing and due diligence over the years. As I started to delve into the literature on business angels, I grew more and more displeased with the way that the research to date had been preoccupied with pre-investment matters, despite the fact that the needs of SMEs clearly lay in the post-investment relationship.

Yet another influence was derived from my involvement in an investigation on BANs. In 2008, I became involved in conducting interviews for a report on the topic of BANs that was being produced for NUTEK (Silver, 2008). This experience also helped shape the emergent themes of my dissertation. Once again, I was able to speak to business angels about the themes of my own dissertation, and even though there was no time to conduct full interviews of my own with these business angels, I was able to test my ideas against their experiences.

At a very basic level, there are inductive and deductive approaches to research (Bhattacherjee, 2012). Both types constitute a circle where the inductive approach generates theory; this theory is subsequently tested through the deductive approach, which then flows back to the inductive approach, thereby generating new theory to fill the gaps in existing knowledge (Pratt, 2008). However, choosing research problems to fill gaps in the existing literature could exacerbate paradigm effects (Kuhn, 1962) by excluding research problems that are too far removed from current theory (Alvesson & Sandberg, 2011). Another way of defining a research problem is by focusing on apparent contradictions in the current literature and aiming for clarification of those contradictions. The point of departure for my own dissertation was a number of apparent contradictions in the current literature. I felt that there were several key tensions in the literature on business angels, such as the potential conflict of interest between the investor role and the mentor role, or the way that investors keep track of control avert entrepreneurs (Berggren, 2002) in a context marked by
ever-changing goals (an early theme that I later abandoned). I also felt that current research was unable to explain what business angels were actually doing, since although it described post-investment activities, it did not reveal the meaning of these activities; it merely described what business angels do, not specifically why or how they do it. The meaning ascribed by participants to an activity is essential for understanding that activity (cf. Berger & Luckmann, 1966).

Perhaps these contradictions indicated that something else was happening, which current theory was unable to grasp. In such a case, it would be better to throw all assumptions and ideas overboard and let the circle swing back to inductive research, which is based on new, firsthand observations.

**Qualitative Research and Scientific Rigor**

As I contemplated ways to achieve my goal of understanding the actions of business angels, I soon realized that this process would involve uncovering what business angels were doing and why they were doing it. Qualitative research is focused on understanding the local, individual case or a limited number of cases (cf. Bryman, 1989). This research approach involves identifying a phenomenon and answering very fundamental questions about that phenomenon. The phenomenon is studied in its natural setting, and it is defined in the language and terminology of respondents in an attempt to understand their subjective interpretations of reality (Denzin & Lincoln, 2008).

Traditional reliability and validity are problematic measures in qualitative research. On the one hand, qualitative research allows proximity to the phenomenon being observed, something that increases the power to understand and define the factors involved in the research problem and their internal causalities. This property of qualitative research ensures high internal validity. On the other hand, qualitative research has low external validity because the
occurrence of the phenomenon studied is unknown. It is possible that the phenomenon is common, but there exists uncertainty as to whether results can be generalized to other settings. Because observations and interviews are key methods for acquiring knowledge, there is very low reliability. For example, if the interviews are performed again tomorrow, the results may be different from those obtained today. The key role of the researcher in posing the questions is not reliable.

As a result, scholars have suggested that one needs to think of reliability and validity differently in terms of methodology, with less emphasis on data collection and more on interpretation and reflection (Alvesson & Sköldberg, 2009). It has been proposed that reliability in qualitative studies must be acquired through transparency throughout the entire research process. By describing the research process and all the decisions made during the study, the researcher enables readers to decide whether they believe the findings from the study. Therefore, I tried to achieve transparency in my research papers and, even more so here, in this description of the entire research process by providing a comprehensive picture of the journey from formulating a research problem, to gathering data, to reading the literature, to analyzing data, to iterating between data gathering, analysis, and reading theory, and finally to writing the papers.

Data Sources

The data sources I used for my dissertation are presented in Table 5. They include primarily interviews conducted with individual business angels as well as the interview material with BANs. Because my dissertation is qualitative in nature and aims to achieve greater understanding, I tried to use any data that became available to me during the years. The information presented in Table 5
is based on research by Bryman (1989), but in some places, other authors are referenced because they supplemented the original list.

Table 5
Data Sources for the Dissertation

<table>
<thead>
<tr>
<th>Data source</th>
<th>Comment</th>
</tr>
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<tbody>
<tr>
<td>Interviews with individual business angels</td>
<td>A total of 23 face-to-face semi-structured interviews with 21 angels, ranging from 1 to 2.5 hours in duration, were recorded on audiotape and transcribed verbatim. One interview was not recorded, but extensive handwritten notes were taken. The interviews were performed from 2008 through 2012. In the beginning, interviews were semi-structured, but toward the end, they became more in-depth, covering fewer topics but in greater detail (Britten, 1995).</td>
</tr>
<tr>
<td>Interviews with BANs and BAN stakeholders</td>
<td>Interviews were conducted with BAN members, as well as a number of central actors, including civil servants, politicians, banks, accountants, and SMEs. Secondary interview material was obtained from the larger project, which was carried by my colleagues in the paper on BANs.</td>
</tr>
<tr>
<td>Conversations with business angels</td>
<td>About 10 conversations—unplanned opportunities for informal interviews that simply emerged by chance during the research period—were carried out with the business angels I interviewed. During such relaxed circumstances, I could pose questions about more sensitive matters.</td>
</tr>
<tr>
<td>Telephone interviews with</td>
<td>A limited number of telephone interviews</td>
</tr>
<tr>
<td><strong>business angels</strong></td>
<td>were performed, mainly to confirm responses to questions during the face-to-face interviews.</td>
</tr>
<tr>
<td>---------------------</td>
<td>-------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td><strong>Conversations with entrepreneurs</strong></td>
<td>About 10 conversations were conducted with some of the entrepreneurs connected to my business angels. These conversations were not full interviews, nor exchanges of friendly banter. Instead, they were unplanned opportunities for informal interviews, touching carefully on some of my topics. This was a question of not risking exposing my respondents to their ventures by posing too detailed and knowledgeable questions.</td>
</tr>
<tr>
<td><strong>Lectures in other contexts given by the interviewed business angels</strong></td>
<td>About five lectures (lectures at universities, talks for SMEs, etc.) were given by the business angels who participated in my study. Furthermore, I taught almost every semester during my doctoral studies, which provided me with the opportunity to include business angels and entrepreneurs among my guest lecturers.</td>
</tr>
<tr>
<td><strong>Indirect participant observation</strong></td>
<td>I was able to participate fully in one context. The business angel in question used to be the chairman of the board for a small venture where I had been a partner a decade ago. During a 2-year period, I was able to observe the interaction between this particular business angel and the CEO, although, of course, most of their actual interaction occurred without me. My observation therefore rests upon being a close confidant of the CEO and listening to him translate the content of their relationship to me. Nearly 10 years later, I was able to put this translation</td>
</tr>
</tbody>
</table>
into perspective by interviewing the business angel and engaging in conversations with him.

While conducting research for my dissertation I was able to observe the actions of both entrepreneurs and business angels in another context. Although I did not attend formal meetings, I had the opportunity to engage in many meaningful conversations with both sides of the dyad over several years, with the timing of some conversations coinciding with some important events.

Documents
Whenever possible, I studied annual reports on the ventures and annual reports on the business angels or BANs, read books written by “my” business angels or BAN members, listened to PowerPoint presentations provided by my business angels or BAN members, and read news items and magazine articles pertaining to them.

Peer checks in the research community
The emergent results from this dissertation and the various papers that have been written based on these results have been accepted and presented as conference papers on four occasions.

Respondent checks
I was able to subject my preliminary findings to the feedback of a workshop with a group of business angels who were not interviewed for this dissertation. I presented some of my findings, and they gave me their opinions and asked questions on different aspects of my research.
As evidenced in Table 5, there are multiple sources of data, and I tried to use as many as possible over the years. Although all these other sources of data exist, my dissertation is primarily an interview-based study, which, according to Bryman’s (1989) classification of studies, is a type 3 study. Bryman described type 3 studies as follows:

Type 3 studies … tend to employ unstructured or semi-structured interviews and documents as sources of data. To the extent that observation occurs, it is largely non-participant, with the researcher being very much on the periphery of interaction, and is undertaken in a somewhat unstrategic manner. (p. 155)

**Interviewing**

The first round of interviews was performed in 2008. During this round, the theme of good cop–bad cop was identified, as well as the potential tension between the role of a mentor and that of an investor. A conference paper was written during this round as a way of “engaging the data” (Locke, Golden-Biddle, & Feldman, 2004)—that is, becoming familiar with the data—tentatively connecting monitoring with sensemaking and procedural justice theory. This paper was a bit rough around the edges and rather short, so it came as quite a (pleasant) surprise when the conference administrators announced that it had been accepted for publication.
This paper titled “When Things Go Wrong” (Berggren & Fili, 2008) is a notable exception to the rule of emergent themes that characterizes the other papers that form part of this dissertation. The final versions of the other papers are all very much the result of a long dynamic over time, with a great deal of iteration involving earlier interviews, literature on business angels and venture capital, theoretical perspectives from other disciplines, new interviews, conference visits and presentations, some observations, archival data, and feedback from journal reviewers and editors.

At the outset, I was not entirely certain what I would find in the interviews, but I knew that I wanted to interview business angels and ask them about normality and abnormality in their venture relationships. Therefore, in line with grounded theory (Glaser & Strauss, 1967), I employed an emergent research logic, wherein I was prepared to adapt my subsequent interviews to themes emerging from the initial interviews. I created a semi-structured interview guide that contained a number of themes that I had identified in the literature and from the regional development projects. A semi-structured interview involves open-ended questions on a number of predefined themes, which allows respondents to use their own terminology, gives respondents the opportunity to raise issues of their own that they deem important, and permits interviewers to ask questions in no particular sequence (Silverman, 2001, p. 92). The open format allows interviewers to gain insight into the respondents’ thoughts and provides respondents with as much time as they need to answer questions. Thus, the respondents decide on the interview topics and guide the direction and the content of the interview. The semi-structured interview guide serves primarily as a guide to the general areas of inquiry that the researcher thinks might be of relevance (Britten, 1995).

My initial interview guide, during the early interviews, would start with the straightforward question to tell me what they do during a day’s work and who they are. This would often land in a historical account of the interviewee’s
personal experience until today. Examples of topics that were included in my interview guide were to ask for stories of when things go wrong and to get them to tell me of especially important parameters for how they perceived the relationship with each venture. I had very vague ideas of what such parameters might look like. I was hoping that this open-ended, semi-structured approach would enable me to uncover what business angels perceived as key events (cf. Van de Ven & Poole, 1990), or “critical incidents when parties engage in actions related to the development of their relationship” (Ring & Van de Ven, 1994, p. 112).

I also used some of the techniques from creative interviewing, as described in the 1997 work by Holstein and Gubrium. Creative interviewing involves a completely different approach than the neutral stance advocated in standard interviewing. Instead, interviewers must be willing to share feelings and deep thoughts so as to encourage respondents to do the same, and to share their own thoughts and feelings in an effort to search for mutual understanding. I embraced the idea of creative interviewing so as to encourage the respondents to engage in an active dialogue rather than being passive respondents. As noted by several scholars, a researcher who conducts qualitative interviewing is the research instrument, and “qualitative interviews require considerable skill on the part of the interviewer” (Britten, 1995, p. 252).

Later, I adapted my style somewhat during the interviewing and tried to perform in-depth interviews on a few selected topics. During those interviews, I brought up various topics, such as mentoring and conflict management, and asked general open-ended questions, and I waited for the respondent to show interest in one of them. In this way, I acted even more like an active interviewer:

Neither elaborate narratives nor one-word replies emerge without provocation. . . . The consciously active interviewer intentionally provokes responses by indicating—even suggesting—narrative positions,
resources, orientations, and precedents. In the broadest sense, the interviewer attempts to activate the respondent’s stock of knowledge (Schütz, 1967) and bring it to bear on the discussion at hand in ways that are appropriate to the research agenda. (Holstein & Gubrium, 1997, p. 123)

I endeavored to create a strong rapport early in the interview process. In a few cases, this approach would, however, result in over-rapport and “nonresearch-relevant conversation” (Dundon & Ryan, 2010, p. 578). At times, I broached subjects that were potentially sensitive. The discussion of sensitive matters may trigger a desire to avoid embarrassment among the respondents (known as social desirability bias), and research has shown that posing structured, projective questions can decrease this bias, through a technique known as indirect questioning (Fisher, 1993). For instance, I would tell the respondents that there was a certain phenomenon that I had heard of during some of the earlier interviews. Next I would ask the respondents whether they had ever heard of this phenomenon (indirect question). Then I would gently probe deeper by asking whether the respondents had any firsthand experience of the phenomenon.

Data Analysis

Holstein and Gubrium (1997) outlined the process of analyzing interviews as follows:

Interviews are traditionally analyzed as more or less accurate descriptions of experience, as reports or representations (literally, re-presentations) of reality. Analysis entails systematically coding, grouping, or summarizing the descriptions, and providing a coherent organizing framework that
encapsulates and explains aspects of the social world that respondents portray. (pp. 126–127)

Bryman (1989) astutely noted that “unlike the analysis of quantitative data, there are few generally agreed rules of thumb for the analysis of qualitative material” (p. 166). Adopting a qualitative approach encourages an open mind during data analysis. However, it also creates a great deal of confusion with regard to the relative suitability of various data analysis procedures, which in turn has opened up the field to many parallel approaches.

One of these approaches is to elaborate patterns in the data and then extend them “to a wider theoretical domain” (Bryman, 1989, p. 167). This approach differs from grounded theory approaches in that it starts in data and generates new theory through progressive inductive analysis, constantly moving backward and forward between data and emergent themes, through stages of coding at different levels of abstraction (Charmaz, 2005). The act of writing is one way of engaging the data (Hammarén, 2005; Richardson, 2000) and searching for patterns. Carrying out this act helps the writer turn tacit knowledge into explicit knowledge.

On the one hand, the current dissertation borrowed aspects from a grounded theory approach, namely, the focus on emergent themes and the way that the data were allowed to guide the research process. On the other hand, the emergent themes were not finalized as new theory derived from the empirical data but rather as something produced in the interface between the current financial theory and the new observations made here. Thus, the emergent themes were intensely compared with existing theory within a broad span of social science so as to determine if similar ideas existed outside of the local theoretical disciplinary thoughts. Through this comparison, empirical themes were connected to previous research findings and interpreted in their light.
This process of systematic combining has been described as an abductive research approach. In this approach, the focus is on the refinement rather than the replacement of current theories.

The researcher sets out with a preliminary theoretical framework, a framework that is subsequently developed and modified in response to empirical discoveries and theoretical analysis. This evolving theoretical framework in turn guides the search for new empirical data in a process that involves going back and forth between theory and fieldwork, as well as the use of various data sources. In their 2002 study, Dubois and Gadde described this process as follows:

The preliminary analytical framework consists of articulated “preconceptions.” Over time, it is developed according to what is discovered through the empirical fieldwork, as well as through analysis and interpretation. This stems from the fact that theory cannot be understood without empirical observation and vice versa. The evolving framework directs the search for empirical data. Empirical observations might result in identification of unanticipated yet related issues that may be further explored in interviews or by other means of data collection. This might bring about a further need to redirect the current theoretical framework through expansion or change of the theoretical model. (p. 555)

Qualitative research has generated many of the most influential theories within management (Pratt, 2008). At the same time, qualitative researchers warn that qualitative interviewing, semi-structured or unstructured, must not be perceived as immediate and valid accounts of human experience because this leads to “analytic laziness” in thinking about the content of the interview data (Silverman, 2001, p. 93).
In the present work, I tried to ensure analytic rigor by subjecting the interviews to extensive iterative comparisons to theory. I conducted a literature review of studies that focused specifically on strategic alliances, interorganizational relationships, social exchange, and organizing in general as a way in which to search for theory that could help interpret the research findings. By comparing these studies, and by keeping a journal summarizing the research on business angels and venture capital, I was able to discern several themes, which I subsequently explored in my papers.

**Limitations**

The study of the post-investment relationship is difficult. The post-investment dynamics demand field studies where variables are impossible to isolate and manipulate. Everyday reality is messy (Parkhe, 1993), and the interactions between investor and venture are difficult to delineate in time (i.e., at which point a particular episode begins and at which point it ends) (cf. Langley, 1999). For several reasons, it is easier to study the pre-investment activities of investors. For example, these activities can be studied with experimental or archival designs. Valuation and screening can be studied in terms of decision making, and research designs can include pure experiments, where investors are given prospects and asked to value them, or to screen possible ventures for investment purposes. All investors can be provided with the same venture descriptions, and in line with experimental designs, different variables can be isolated and manipulated. Contract design can be studied with high validity by analyzing and comparing actual investor–venture contract documents.

It is important to note that the phenomenon being studied is the noncontractual governance strategies of business angels in the post-venture relationship. Studying a relationship necessitates learning about both sides. Studying how one side perceives the other side does not necessitate learning
about both sides. The present dissertation is not primarily an attempt to describe “what really happened.” Instead, I wish to capture what business angels perceive as suitable strategies for handling ventures in different situations during the relationship and why they are suitable. When interviewing business angels on their experiences and the way they have handled critical events during the venture relationships, I tried to keep the interviews focused on actual events. In addition, I tried to perform triangulation whenever possible so as to facilitate the validity of the data—that is, to complement the interviews with other sources on these events.

Research involving the interviewing of successful business angels seems to be lacking (cf. Denrell, 2003). Despite the fact that research on organizational effectiveness has been the holy grail of organization research for decades, no clear answers have been produced regarding the factors leading to such effectiveness (Bryman, 1989, pp. 233–239). In the same way, there is no clear answer as to what leads to success in the individual venture relationship, and there is no single definition of what success constitutes in each individual venture. Each investment is a nexus of the business angel, the venture, other investors and stakeholders, the unique characteristics of the venture (entrepreneurial team, technology, market potential, etc.), the macroeconomic context, and, of course, pure luck. The focus here is the governance strategies of business angels—not their effects. These effects are difficult to define in a meaningful way. Is it the way in which the venture perceived the activities of the business angel, is it the economic performance of the venture, or is it the return on investment of the business angel?

How each investment turns out is thus dependent on very many variables, and it is difficult to isolate what happened in each case. Therefore, interviewing only successful angels is a fallacy: one would not be sure what had led to success in their investments. However, if one believes that business angels learn from each investment—although learning may sometimes occur slowly
and even involve drawing the wrong conclusions initially—one can approach the matter from another angle, that is, by focusing on the experiential knowledge of business angels in general. The business angels interviewed for this dissertation have all made a number of investments, some highly successful and others the very opposite.
Results and Conclusions

It is my hope that the results from this dissertation is of use to many different scholars. First and foremost, I hope that it will be of use to researchers on business angels and investors in general, but I also hope that researchers in the larger field of corporate governance may find it interesting. Although corporate governance has traditionally been focused on the formal structure internal to the organization, new perspectives on corporate governance include (informal) behavioral structures and processes both inside and outside the organization, where corporate governance moves from “designing optimal incentive and monitoring structures” toward interorganizational “normative compliance” through symbolic management (Hambrick, Werder, & Zajac, 2008, p. 382). In the current dissertation, the focus is on such interorganizational governance, as evidenced in the relationship between investor and venture, and the symbolic management of conflict, as evidenced in the paper on the good cop–bad cop negotiation strategy.

The Research Problem Revisited

The purpose of the dissertation is “to analyze the noncontractual governance strategies used by business angels for post-investment venture coordination and control, in relation to the individual venture relationship and the business angel network of the business angel.” In this subsection, the contributions of the papers arising from this dissertation and how they fulfill the purpose of the dissertation are described. All authors have contributed equally to each paper, and appear in alphabetical order.
Table 6

The Papers Included in the Dissertation in Their Order of Appearance in the Text

<table>
<thead>
<tr>
<th>Paper</th>
<th>Author, Year</th>
<th>Title</th>
<th>Publication Status</th>
</tr>
</thead>
<tbody>
<tr>
<td>Paper 2</td>
<td>Fili, A., 2014b</td>
<td>Mentoring the CEO or Monitoring the ROI? Interrole Conflict in the Business Angel–Venture Relationship</td>
<td>Working Paper Series, Department of Real Estate and Construction Management &amp; Centre for Banking and Finance</td>
</tr>
</tbody>
</table>
Paper 1 is a review of the current research findings on the post-investment activities of business angels in the venture relationship. The next three papers (papers 2–4) are empirical investigations of the post-investment strategies for coordination and control used by business angels, investigating harmony and conflict in the relationship. Paper 2 explores coordination during normal everyday life in the post-investment relationship; paper 3 focuses on how angels perceive that something is going wrong with the relationship, as goals diverge between the business angel and the venture; and paper 4 examines how business angels exercise control as they negotiate with the venture so as to overcome such goal divergence. The last paper, paper 5, deals with the evolution of BANs in terms of financial, human, and social capital.

The first paper listed in Table 6, “Business Angel Post-Investment Activities: A Multi-Level Review” (Fili & Grünberg, in press), is a conceptual paper. It is a literature review of current findings on the post-investment activities of business angels. The review not only summarizes the findings that have been published to date but also tries to link these findings to theory outside the traditional finance literature. The underlying idea is that much of the current research on business angel post-investment activities makes use of concepts and terminology that are empirically derived and simply inherited from earlier studies. “Acting as a sounding board” is one example of the activities carried out by business angels. In this activity, business angels allow others to bounce ideas off them about the venture. However, more precise concepts exist within social science, notably within psychology, sociology, social psychology, and management. Does being a sounding board equate to being a leader, a manager, a therapist, a mentor, or simply a friend? Is the content of these talks about operative daily concerns, or is it of a strategic nature? Are private matters discussed?

The aim of conducting a review is to probe the potential in making such a connection to extradisciplinary concepts. Thus, findings from earlier research
are reviewed in terms of organization theory. In their study, Fili and Grünberg (in press) suggested that current activities can be conceptualized as five separate governance processes used by the business angel to organize the venture relationship. These five governance processes are boundary spanning, structuring, leadership, doing, and monitoring. Somewhat simply put, boundary spanning means acting as a foreign minister for the venture’s sake. Structuring means setting the rules of the game, leadership means being the coach of the team, and doing means being one of the players on the team. Monitoring is an important process that is partly accessible through the other processes. Even though the paper is a review and primarily an illustration of the potential hidden in adopting such a theoretical perspective, this paper argues that conceptualizing business angel activities as organizing activities will give access to robust theory and enable a deeper understanding of these activities in future research. Because much of the research to date has been undertaken without this theoretical connection, the paper concludes by calling for different questions to be posed, a return to inductive research, and the use of qualitative methods.

The second paper, “Mentoring the CEO or Monitoring the ROI? Interrole Conflict in the Business Angel–Venture Relationship” (Fili, 2014b), focuses on understanding what mentoring means in the business angel context. In its normal context, a mentor is a trusted senior person who provides guidance and support to the protégé. Earlier research has indicated that business angels are perceived as mentors by venture members. An argument put forward in this paper is that an investor does not always have the protégé’s best interests in mind and, at times, prioritizes the return on investment instead. In some situations, this role conflict might become severe. If the business angel continues in the mentor role, the venture could embark on a very costly and risky course of action, whereas if the business angel switches to the investor role, this course of action could be vetoed through the authority of the investor. Presumably, switching from the role of mentor to that of investor in this
fashion would destroy the trust held by the protégé that the business angel really had the protégé’s best interests in mind. This role conflict between being both an investor and a mentor is explored in the paper. Based on information gathered from interviews with business angels, an image emerges wherein the business angel remains in the mentoring role for as long as possible, given the perceived costs. The paper suggests that an understanding of mentoring in investor–venture relationships benefits from the concept of affordable loss (Sarasvathy, 2001).

One of the implications of affordable loss for an entrepreneur is envisioning the worst-case scenario and the money lost in that case (Dew, Sarasvathy, Read, & Wiltbank, 2009). For a business angel, affordable loss could mean the same as what it means for an entrepreneur. The business angel could picture the cost of the worst-case scenario by studying the current course of action and decide whether it is affordable or not. As long as the worst-case cost associated with a certain course of action is lower than the affordable loss, the business angel will continue to fulfill the role of mentor in support of the venture chief executive officer (CEO). However, if the cost exceeds the affordable loss limit, the business angel will switch to the monitoring role, thereby prohibiting this course of action.

Paper 3, called “When Things Go Wrong: Business Angels’ Use of Cues in Judging Their Investment Relations” (Berggren & Fili, 2008), is an empirical study that investigates monitoring in the post-investment relationship. The paper focuses on the different cues extracted by the business angel that signal that the relationship is experiencing trouble. Six cues emerge as indicators: the outright rebellion, the strange report, the missed deadlines, the history revision, the changes in information flows, and finally the refusal to maintain contact by going underground. The outright rebellion occurs when the venture refuses to cooperate with the business angel. The strange report is when the business angel receives reports from the venture that contain unexpected accounting data. The
cue missed deadlines occurs when the venture continuously misses deadlines. The history revision means that the venture tries to rewrite the past by arguing that something did not happen in the way that was previously agreed. When the business angel suddenly comes across information from an unexpected source, this is referred to as a change in information flow. This information should have appeared in another way, but the information flow has been suddenly changed. The final cue is the refusal to maintain contact by going underground. In this situation, the venture refuses to answer when the business angel tries to make contact. Some of the cues are considered serious breaches of trust, whereas others merely trigger the business angel into action but do not initially reduce trust. It seems that as long as the cues are absent, trust-building activities dominate; however, as soon as cues emerge, trust-building activities halt, and monitoring starts. To put it differently, as long as there is goal convergence between the business angel and the venture, there is a focus on coordination. When the cues indicate the beginning of goal divergence, the focus shifts to control.

Paper 4, titled “Business Angel–Venture Negotiation in the Post-Investment Relationship: The Use of the Good Cop, Bad Cop Strategy” (Fili, 2014a), is focused on understanding what happens after things have gone wrong—that is, a situation from which the need for negotiation has arisen. The paper reports on the use of the “good cop–bad cop” negotiation strategy in ongoing investor–venture relationships. Four cases of business angel–venture involvement are studied over several years. Earlier research on the good cop–bad cop strategy has described its efficiency in short-term distributive bargaining. This finding has been explained by the unlocking of the emotional contrast effect that occurs when an interaction with a bad cop is followed by an interaction with a good cop. In an ongoing investment relationship, other rules apply. The present findings suggest that only a business angel who is already trusted can become a good cop—by virtue of introducing a bad cop.
Conducting negotiations in this manner prevents the destruction of the trust that has been built over time in the business angel–venture relationship. The strategy provides a scapegoat for the negativity associated with the negotiations. The bad cop assumes the blame, whereas the good cop is still trusted and can remain in the relationship, with less risk of being the target of any retained hostility.

Paper 5, “The Impact of Financial Capital, Human Capital and Social Capital on the Evolution of Business Angel Networks” (Fili, Berggren, & Silver, 2013), focuses on the evolution of three BANs from their inception. This study indicates that the evolution of each particular BAN depends on a combination of the financial, human, and social capital of its founders. One of the BANs under investigation included members who had substantial financial resources, whereas another BAN included members who were not so wealthy. Even so, the wealthy BAN shut down operations after 2 years because of a lack of consensus on common processes for managing the investment process. Meanwhile, the not so wealthy BAN flourished—an outcome that is attributed to the consensus on a common model for managing the investment process. In this way, each BAN developed differently. This type of development in turn had a great impact on the way that individual business angel members were free to act.

On its own, paper 5 is summed up by the preceding paragraph. However, when analyzed in conjunction with the other papers, the implications for the purpose of the dissertation are that a BAN can provide either freedom of action or restrictions on action. Simply put, restrictions are exemplified by a situation in which a business angel would—if free to do so—choose governance strategies that differ from those chosen by the BAN. The flexibility of the business angel, the very essence of the informal investor, would be endangered by the structured approach of the BAN.
**Implications for Theory**

Earlier in this dissertation, I stated that there are a number of competing theoretical perspectives on the post-investment governance of business angels in the venture relationship. However, part of the theoretical contribution of this dissertation is to show that these perspectives are complementary, not competing, and that they have explanatory power, depending on the organizational status of the business angel.

In line with this, the first contribution is the discussion on organizational membership—that is, of being an outsider or an insider. The activities performed by business angels during the post-investment relationship can be seen as governance processes. The choice of each individual governance process is guided by whether the business angel is a venture outsider or a venture insider. Specifically, I argue here that the outsider engages in negotiated exchange, whereas the insider engages in reciprocal exchange. Gabrielsson (2003) suggested that the governance exercised by company boards belongs to either a control- or a service-oriented logic. The control logic draws on the agency theoretic tradition (Jensen & Meckling, 1976) and states that the primary function of the board is to exercise control. The service logic, by contrast, draws on the stewardship and a resource dependency theory, and suggests that the primary role of the board is to help the firm by providing advice and facilitating access to resources. The governance processes employed by the venture outsider are typically more control oriented. However, I suggest that business angels, in their role as lead investor, try to create mutual trust in the venture relationship, thereby becoming either a co-entrepreneur or a mentor. The governance processes employed by an insider are not control oriented, but service oriented.

The five governance processes described by Fili and Grünberg (in press) are generic and present regardless of whether the business angel is an outsider
or an insider. However, it is reasonable to expect that governance processes with strong formal components, such as structuring and monitoring, are the ones that are most accessible to the business angel outsider. By the same logic, it is reasonable to expect that a governance process such as leadership, based on identification, is only fully accessible to the business angel insider. As for doing, it can be conceived of as meddling or contributing. I expect that an outsider becoming involved in doing would be considered as meddling, whereas an insider becoming involved in doing might be considered as contributing. In the same way, scholars have argued that structuring through formalization can be conceived of as not only a negative way of restricting individual initiative but also a positive way of increasing coordination and communication (cf. Jansen, Tempelaar, Van den Bosch, & Volberda, 2009; Vlaar et al., 2007a).

The same line of argument goes for monitoring. Monitoring occupies a central position in earlier research in the field of venture capital and business angel investments. In the present work, monitoring emerges as a spectrum between two extremes, where it can be perceived as strong or weak. At the end of the spectrum where monitoring is perceived to be strong, there is panopticism (Foucault, 1974)—a controlling, obtrusive monitoring, where the subject being monitored is acutely aware of the fact, and monitoring incurs a strong behavioral effect. Garg (2013) referred to this strong form of monitoring as excessive monitoring. Because of its costs in terms of reduced motivation of those being monitored, Falk and Kosfeld (2006) warned against it.

Instead, it seems that there is a weak form of monitoring that is acceptable in relationships. In the 2008 study by Berggren and Fili, business angels were interviewed about how they become aware of problems in the venture relationship. These business angels stated that they continuously monitor the interaction with the venture for signs of anomalies. These cues, when aroused, trigger a sensemaking process, but the continuous monitoring itself is a weak form of monitoring—in that this scanning for exceptions is
unobtrusive and low intensive, and occurs silently. The weak form of monitoring seems to be acceptable and does not seem to incur any behavioral changes; instead, it seems that this is a kind of monitoring that all individuals engage in routinely.

Linked to the discussion of insiders and outsiders is the meaning of mentoring in the business angel context. In a number of earlier studies on business angels, there are references to mentoring in post-investment venture relationships. Furthermore, studies have mentioned that business angels frequently act as sounding boards. However, it is unclear what these labels actually mean and if they mean the same thing across the different studies. For example, in a German study by Stedler and Peters (2003), mentoring was used to describe the entire post-investment activity on the part of the business angel, the same general post-investment involvement that Van Osnabrugge and Robinson (2000) labeled as monitoring. In the present dissertation, a qualitative, interpretive approach was chosen so as to capture the meanings ascribed to various activities by the business angels. It seems that the meaning of mentoring in this specific context is the same as that used in a general setting. These business angels are able to fulfill both the role of an investor and that of a mentor by becoming primarily insiders.

The second major contribution is the idea of preferences as being endogenous or exogenous. According to previous research, preferences are defined as exogenous or endogenous to the venture relationship. In the present dissertation, it is clear that when the business angel becomes an insider, preferences are better viewed as endogenous; however, when the business angel is an outsider, preferences are better understood as exogenous. Whereas the outsider is able to influence venture behavior by providing extrinsic motivation to the venture members (because their preferences are exogenous), the insider is able to influence the preferences themselves (because the preferences have become endogenous to the relationship). The importance of being able to
influence preferences is especially strong in a context marked by a high degree of ambiguity. Even with milestones and qualitative goals, the newness of the venture may demand the constant updating of goals and business strategy. Ouchi (1979) described this context as follows:

Under conditions of ambiguity, of loose coupling, and of uncertainty, measurement with reliability and with precision is not possible. A control system based on such measurements is likely to systematically reward a narrow range of maladaptive behavior, leading ultimately to organizational decline. It may be that, under such conditions, the clan form of control, which operates by stressing values and objectives as much as behavior, is preferable. (p. 845)

Potentially, neither the output of the venture nor its work process can be measured in any meaningful way, which could translate into a lot of negotiation and renegotiation of terms and the setting of new goals. Control under such conditions of ambiguity is greatly facilitated by becoming an insider with the ability to influence preferences through clan control.

Table 7
A Comparison of the Outsider Role and the Insider Role

<table>
<thead>
<tr>
<th>Outsider role</th>
<th>Insider role</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investor</td>
<td>Co-entrepreneur, mentor</td>
</tr>
<tr>
<td>Negotiated exchange</td>
<td>Reciprocal exchange</td>
</tr>
<tr>
<td>Access to “bad cop”</td>
<td>Access to “good cop”</td>
</tr>
<tr>
<td>Bureaucratic control mechanism</td>
<td>Clan control</td>
</tr>
<tr>
<td>Strong monitoring</td>
<td>Weak monitoring</td>
</tr>
</tbody>
</table>

In Table 7, the two roles of outsider and insider are juxtaposed. At this point, it is worth reminding the reader that the role of outsider is not automatically
negative. Being an outsider gives freedom of action. By contrast, the insider is hampered by loyalties. The outsider may be able to extract information that is not biased by strong ties (Granovetter, 1973). Some may even choose to remain an outsider so as to keep things on a strictly professional level. For example, the outsider may be able to manage the exit from a venture differently, and for this reason, the outsider may have a totally different emotional experience from that of the insider. Perhaps the insider is not the one who is better off after all.

The general findings are that business angels can be perceived as not only outsiders but also insiders by the venture and that this perception can change over time in the same relationship. Thus, the use of agency theory is appropriate at certain points or events in a relationship (Arthurs & Busenitz, 2003), such as during bargaining or conflict, in a setting where the exchange is of a more competitive nature. At other times, a theory of norm-based influence is much better suited for understanding the relationship, where preferences can be changed and influenced through the interaction between the investor and the investee.

The basic idea is that, over time, a business angel will make the transition from an outsider to an insider. Thus, in the beginning of the venture relationship, the business angel is an outsider, engaged in nearly pure negotiated exchange. Over time, if there are trust-building activities in the venture relationship, the business angel moves progressively toward a position of insider, engaged in predominantly reciprocal exchange. Suddenly, there are cues that indicate that things are going wrong in the relationship. These negative cues trigger sensemaking processes where an assessment is made of the gravity of the situation—that is, whether the limits set by affordable loss are transgressed. If the situation is serious enough, there will be a need to engage in negotiated exchange. As evidenced in the findings from negotiations in paper 4, the insider and outsider roles are not easily combined, which is why some insiders brings in an outsider during times of negotiation and conflict. After successful
negotiations are closed, the insider remains in the venture relationship, and the bad cop departs. In this idealized description of the post-investment relationship, the contribution of paper 5 is the potential impact of a BAN on the relational strategies of the individual business angel. This impact could occur in one of two ways; the BAN could exercise restrictions on the behavior of the business angel, or it could offer larger degrees of freedom in behavior (access to a larger range of behaviors), as evidenced by the good cop–bad cop negotiation strategy. With access to a larger pool of potential bad cops, the good cop would presumably be able to negotiate more easily.

Implications for Practice and Policy

There are a number of implications for investors and ventures. The first implication is that investor activities can be conceived of in terms of combinations of five different governance processes—some of which are synergetic and others are not (i.e., the individual processes neutralize each other). As investors become aware that they are engaging in these five processes, they can learn more from research on each individual process and on the combinations of these processes (and in so doing, avoid those combinations that are harmful).

The second implication is that the post-investment relationship is dynamic over time. Thus, the suitability of governance combinations will change over time. Both the investor and the venture harbor expectations for each other, and as long as these are met in a consistent manner, and through open communication, the relationship can evolve in a trust-building direction, resulting in the investor eventually becoming an insider.

The third important implication for investors and ventures is that the involvement of investors in the venture should be thought of in terms of two separate roles: the outsider and the insider. When an investor assumes an insider
role, such as the role of mentor or that of co-entrepreneur, the venture is benefited in terms of a more informal relationship. In such an informal relationship, decisions can be made quicker, information and knowledge can flow more freely, and greater focus can be put on achieving venture growth (managing market risk) than on controlling each other (managing relational risk). A tension exists between the two roles, as the investor's goal of return on investment may at times diverge from the mentor's goal of protégé psychosocial support and development. Both the investor and the venture should be aware of this tension and consistently treat each other with respect.

There are two buffer functions that protect the insider role. The first is affordable loss. As long as the perceived costs of venture action are less than the affordable loss, the investor can continue to fulfill the insider role and provide full psychosocial support. Once the affordable loss is passed, the investor needs to nudge the venture in the right direction again; however, the investor still wants to remain in the insider role. In this type of situation, the good cop–bad cop negotiation strategy is employed. Both the investor and the venture need to acknowledge that this ritual is deeply rooted in human nature, with the scapegoating function and the causal attribution, and that it fulfills an important function in the investor–venture relationship.

The last managerial implication is the way that the BAN affects all this. For a BAN to function properly, there must be agreement as to which model to use in conducting the business angel investment process. Financial capital is not enough. In other words, a certain amount of formalization is necessary. However, the strength of the insider role lies in its informal nature. It seems that there is a paradox between the strength of the individual business angel and the needs of the BAN. However, Vlaar et al. (2007b) have suggested that formalization can be of such a general level of abstraction that the freedom of action of the individual is not hindered.
For policymakers, I think that the current dissertation highlights how venture development and success result from the interplay involving three different effects. First, there is the relational effect arising from the relational dynamics between the business angel and the venture. Second, there is the market effect arising from the way in which the venture manages its environment in terms of market success. These two are generally recognized as relational risk and market risk, respectively (Das & Teng, 1998). The third effect, added in this dissertation, is the syndication effect. This is the effect on the venture relationship emanating from how the actions of the individual business angel are influenced by the structure and culture of the BAN.

**Future Research**

In my view, there are three major avenues for future research. The first avenue would be to try to describe the limits of the insider and outsider roles. This avenue would include studying role changes in both directions and determining whether a change in one of the directions is irreversible. In other words, is it possible to switch from the role of insider to that of outsider and then back again, and repair the trust lost (cf. Kim, Dirks, & Cooper, 2009)? Is being an insider simply a fluid language game, or is it a matter of socialization, situated at the deep roots of identity formation? It seems to me that a catch-22 exists; some of the governance strategies lead to becoming an insider, whereas some become available as a consequence of being an insider. Conversely, some strategies are suited only to the outsider, and these strategies make an outsider remain an outsider. How is the transition managed from outsider to insider?

The second avenue would be to undertake quantitative investigations of the frequency and the occurrence of strategies such as good cop–bad cop, weak versus strong monitoring, and bureaucratic control versus clan control—not only in the business angel population in Sweden but also among the investment
managers in VC and buyout firms. Are these strategies widespread? Do any differences and similarities exist among the different groups and within different industries?

The third avenue would be to conduct a survey of interpersonal influence mechanisms among business angels. Leadership theory predicts that such visionary leadership on the part of the business angel would be very well suited to the venture setting, which Shamir et al. (1993) aptly described as follows:

Furthermore, in unstable conditions or when a new organization is being formed, there is more ambiguity and anxiety and a greater need for orientation on the part of organizational members. Under such conditions, members are more likely to look for charismatic leaders and to accept their definitions of the organization’s identity and its mission.

(p. 589)

The link between mentoring and transformational leadership has been established (Scandura & Schriesheim, 1994), and it is also well known that business angels act as mentors. Administering a leadership questionnaire, such as the Multifactor Leadership Questionnaire (MLQ) developed by Bass and Avolio (1997), would make it possible to know to what extent business angels rely on the entire range of leadership behaviors in interactions with their ventures.
References


Appendix: the Papers

Paper I

Paper II

Paper III

Paper IV

Paper V