GÖTEBORGS UNIVERSITET
HANDELSHÖGSKOLAN

Does agency theory or stewardship theory apply to the venture capitalist-entrepreneur relationship?

Bachelor Thesis in Industrial and Financial Management, FEG314

Caroline Lindqvist and Dusjan Mijovski

Mentor: Stefan Sjögren

Fall 2012

Keywords: agency theory, stewardship theory, asymmetric information, venture capital

Abstract

Individuals, who have great ideas they want to realize, face the problem of how to be able to raise capital. Instead of just giving up their wish to establish a company that could be successful they can get the financial support from venture capitalists. In return for their financial help to the entrepreneur, venture capitalists normally demand a high return on their invested capital. Although this may seem as a very easy way to raise capital, venture capital funding is surrounded by a number of risks and special caution has to be taken to prevent any big losses. The main problem facing the venture capitalist is the asymmetric information between the venture capitalists and the entrepreneur and we have examined this problem through the agency and stewardship theories. Depending on how the two different parties act toward each other and how they see themselves in context of the organization, this will have effects on the success for the venture.

For this thesis we have chosen to do a case study of Chalmers Innovation and had an interview with their investment manager Per Stenman. We have also used secondary data to outline a theoretical framework, which we will use to test the probability to how the actual process is executed. Our findings are that venture capital firms use contracting to prevent the problems that can occur with agency theory and with the help of contracting a principal-stewardship relationship will emerge where no agency costs occurs.

For further research it would be interesting to investigate the entrepreneur's perception of the collaboration as well as interview other venture capital firms and see if there are differences in how they work.

Keywords: *agency theory, stewardship theory, asymmetric information, venture capital*

Preface

Through the work with our thesis we have learned a lot about how the venture capital sector function as well as the problems with asymmetric information between the parties in the cooperation. Before we began to write this thesis we had a great curiosity about the venture capital sector and in hindsight, interest only increased. It is a very exciting area to explore, as we discovered difficulties in successfully finding venture capital firms who want to participate. Even though we faced difficulties in our work progress, when we finally got an interview with Per Stenman at Chalmers Innovation, we did not regret the choice of subject since it was fascinating to hear about how the venture capital firm works in reality.

We would like to thank Per Stenman for taking the time to see us, and contributing with valuable information for the realization of this thesis. Continuing, we will also thank our mentor Stefan Sjögren for having supported us and provided great feedback during our work. We would also like to thank Martin and Helena, Johan and Daniel who were in our supervising meetings and helped us in the right direction with valuable input.

And special thanks to Sarah Haack for taking her time to read through this thesis, giving guidance and tips on the language

Best wishes,

Caroline Lindqvist
Dusjan Mijovski
School of Business, Economics and Law, University of Gothenburg 2013-01-08

Contents

Table and figure list

1. Introduction

In the today's market economy, there exists a myriad of entrepreneurs who sit with innovative ideas just waiting to put them into action. They will eventually find that funding these ideas is easier said than done, since banks would reluctantly lend money without any collateral. This is where venture capital firms and their assets enter; the assets take form in capital, knowledge, and firm's possession of networks. In return for their willingness to take the risk in investing, venture capital firms require a return (Eklund & Sandström, 2009). Investments normally take place in companies that the venture capital firm considers to have a growth-potential. Venture capital, along with *informal investments* and *buy-outs,* belongs to a sector of financing called *private equity*. The other is *public equity*, found on the stock exchanges around the world.

Venture capital financing has become an increasingly important source of financing and it is a very debated and contemporary form of investment. The venture capital firms not only contribute with capital, but also with know-how in fields that could be a valuable asset for the entrepreneur. Through the venture capitalist the invested company also gains access to a broad spectrum of customers and suppliers (Eklund & Sandström, 2009).Venture capital firms have been extremely successful the last few decades, and they have been associated with a number of successful companies like Spotify (Creandum, 2013), Yahoo and eBay (Kaplan & Strömberg, 2001).

The main purpose of venture capital firms is to create value in the business in which they invest, thus producing a return for the investor. Venture capital firms' investments are temporal. There are three forms of exiting a company; one being a sell-off, the other being an introduction of the company on the stock exchange and the third is bankruptcy. When a venture capitalist exits the venture, the difference between the start-up value and exit-value of the invested company is the return in which the venture capitalist is interested (Isaksson, 2006).

When deciding upon a portfolio company the venture capitalist faces the problem of discrepancies in the information flow. One such discrepancy is asymmetric information, in which the venture capitalist is never sure whether the entrepreneur is being transparent with his or her ideas and information given before settling on a contract. This is avoided by an indepth screening process before the contract is finalized and the clauses agreed upon. (Stenman, 2012)

Finally, the roles and alignment of goals by the two different parties throughout the funding process is crucial for the future of the venture. These are outlined by the agency and stewardship theories, which outline to what extent the different parties are willing to empower each other, as well as the level of control and trust they have for each other (Bender, 2011).

1.1 Problem background

The reason why we chose to examine agency theory and stewardship theory through venture capital financing is because of the complex relationship between the venture capitalist and the entrepreneur and thus it is interesting to see if any of the theories are applicable to the relationship between the parties. Furthermore, venture capital is suitable for this analysis, since previous research has been done in this area. The problem that could arise from this arrangement is asymmetric information between the venture capitalist and the venture. The venture may have information about their firm that they might not share with the venture capitalist. Asymmetric information is related to two concepts, adverse selection and moral hazard. Adverse selection is a result from concealed information that could contribute to bad investments, and moral hazard is the possible risk that the entrepreneur does not act for the venture capitalist's benefit. This problem of risk is usually reduced by the venture capitalist through contracting, which determines for example the voting control and decision rights (Isaksson 2006).

Another problem is the respective roles of the venture capitalist and the entrepreneur and how the two parties interact with each other. The problem lies in the difficulty of aligning the different interests of the venture capitalist and the entrepreneur, as well as the level of control of the process. Stewardship theory implies that both the agent and the principal work towards the same goal and therefore no agency cost occur. In practice this is difficult to manage, especially since the venture capitalist may change his or her role during the funding process. It is also discussed whether the stewardship is an actual theory of its own or just an extension of the agency theory (Bender, 2011).

1.1.1 Defining venture capital

Risk capital involves active ownership, where the venture capitalist invests both capital and knowledge, and together with the entrepreneur builds successful companies. Risk capital works as a catalyst in the Swedish economy and is of great importance for growth and job creation (SVCA, 2012).

The equity capital is divided into public and private, depending on whether or not the company is listed. Private equity is divided into three subgroups; informal venture capital, formal venture capital and other private equity, as shown in figure 1. Informal venture capital, also known as business angel, is characterized by investments made by a single wealthy individual and its private capital is used (SVCA, 2012). Formal venture capital is referred to as classic venture capital, while other private equity is sometimes referred to as just private equity (Isaksson, 2006), with most investments concerning mature companies with development potential (SVCA, 2012).

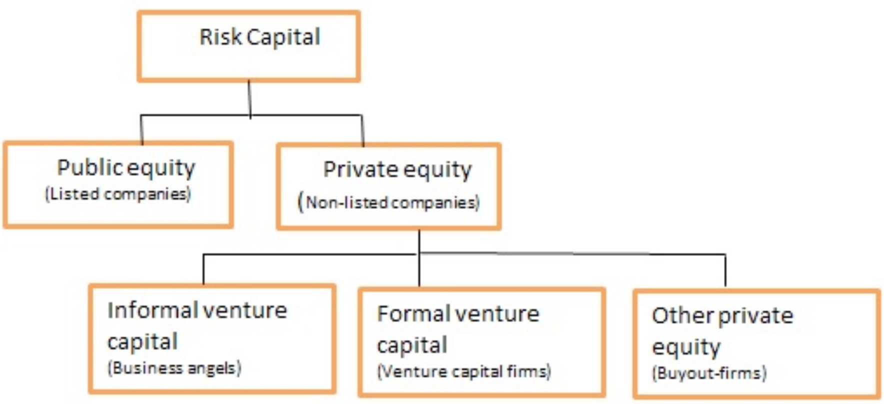

Figure 1 ***The definition of formal venture capital and its related parties***

Formal venture capital is funding given by venture capital firms. It concerns investments in early stages of a company's development, often an entrepreneur who only has one idea that he or she wants to realize. This is the part of private equity that we will focus on in our thesis.

1.1.2 The venture capital process

The process concerns the relationship between the venture capitalist and the entrepreneur who is in need of capital. It is important to define the actors in order to completely understand the process described. First, we have the investors who fund the entrepreneurs. Second, we have the venture capitalists that serve as intermediaries. Third, we have the entrepreneurs who are in need of funding. The first and second actors in this process represent the supply side of venture capital while the third part represents the demand side (Isaksson, 2006). The relationship between the three actors is illustrated in figure 2. In our thesis we are focusing on the relationship between the venture capitalist and the venture.

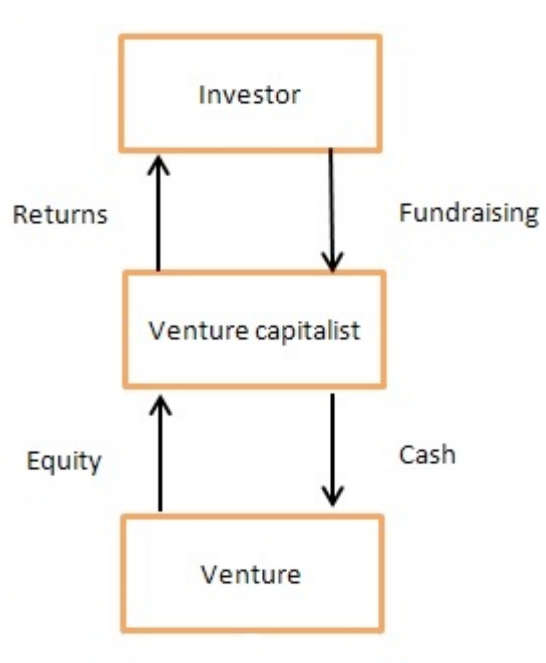

Figure 2 ***The relationship between the three actors in the venture capital process (Landström, 2007).***

The venture capital process is a series of activities that each venture firm works through from the time the entrepreneur first proposes his or her idea until the time when the venture capital firm successfully, or unsuccessfully, exits and takes its profit (Landström, 2007). One of the most well-known articles published regarding venture capital process was proposed by Tyebjee and Bruno (1984) and consists of five different activities. This model is important to know to understand the contracting phase. The five activities are seen in figure 3, seen below.

Step one – *Deal origination*. The venture capital firms face an inadequately defined environment with the lack of historical data about their investment prospects. The typical prospect is a small company with an innovative business plan. To identify a good investment opportunity for the venture capitalist firms they need to have faith in various intermediaries in matching them with entrepreneurs with the need of capital.

Step two – *Deal screening.* When screening for the investment opportunities the venture capital firms must screen a large number of potential investments. Their different screening criteria depend on the area in which the firm is familiar and interested in.

Step three – *Evaluation.* As said before, the venture capital firms are faced with lack of historical data from their ventures. Therefore the firms have to rely on the business plan presented by the entrepreneur. The venture capitalists do consider risk and return when deciding but, because of the lack of historical data, this is rarely sufficiently credible, therefore they have to use a set of other characteristics to evaluate whether or not to invest. The three most important characteristics according to the authors were management skills and history (with 89 percent), market size and growth (with 50 percent), and last rate of return (with 46 percent). Worth mentioning is that recent studies cannot show any correlation between these characteristics and the investment selected by the venture capitalists.

Step four – *Deal structuring.* When the venture capitalist has decided that the proposed idea is acceptable, there is a deal only if the venture capitalist and the entrepreneur are able to construct a mutually acceptable capital investment agreement. This agreement is valuable for both parties but serves several purposes for the venture capitalist such as determining the price of the deal and establishing covenants, which allows them to take control of the board and make necessary changes if required. This part of the process is crucial for the collaboration to emerge and to regulate the relationship, which makes this step important in our thesis and thus culminates to our second research question.

Step five – *Post-investment activities.* Once the deal has been agreed and accepted, the role of the venture capitalist changes from investor to collaborator. The intensity of involvement differs from one venture capitalist to another. Though, most of those interviewed in the survey agreed that it is undesirable to gain control of the daily business. If the venture faces a crisis, then the venture capitalist will intervene and make sufficient changes such as replacing the management team. The venture capitalist usually wants to cash out their gains within five to ten years. To get there, they play an important role for the venture's future and need to position the company in the right direction, either towards merger, acquisition or a public offering.

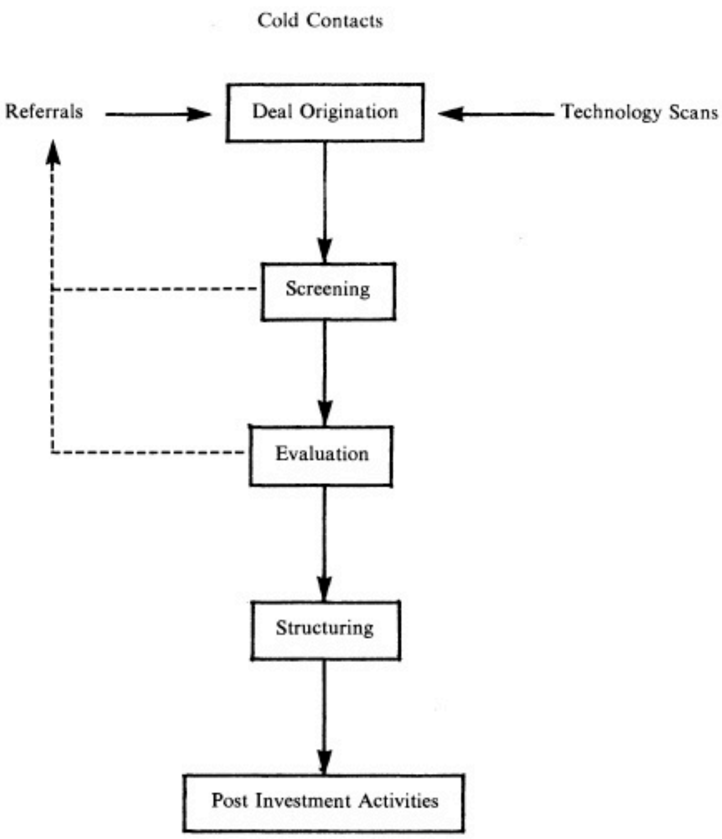

Figure 3 ***The relationship between the five steps in the venture capital process (Tyebjee & Bruno, 1984)***

1.2 Research questions

- Does agency theory or stewardship theory apply to the relationship between the venture capitalist and the entrepreneur?
- Is the contracting phase important to minimize the possible risk of asymmetric information between the venture capitalist and the entrepreneur?

1.3 Aim of the thesis

The purpose of this paper is to examine one venture capital firm with the aim to give a conclusive understanding of the practice within the venture capital industry, focusing on the asymmetric information that can occur between the venture capitalist and the entrepreneur and examining this to see if either the agency theory or the stewardship theory is applicable to on the relationship Furthermore, we will examine if the contracting phase is important to build a durable relationship between them.

2. Method

2.1 Method of analysis

When a scientific study is written, one usually chooses between qualitative method, quantitative method or a combination of both. The basic difference between the methods are that quantitative method converts the information to numbers and amounts which are then used for statistical analyses while in qualitative method, it is the researcher's perception and interpretation of information that is analyzed (Holme & Solvang, 1997).

We have chosen to do a qualitative study and through our interview we obtained an empirical ground from which we constructed a broader basis to examine our questions (Holme & Solvang, 1997). We have done a case study of Chalmers Innovation, and analyzed the company's perception and interpretation of information against our chosen theories. The reason for choosing Chalmers Innovation is because they have a long history in this field, they have survived the IT bubble and the recent financial crisis in 2008, and they have also invested a lot of money in their ventures.

There are three types of case studies: descriptive, interpretive, and evaluative, depending on the type and purpose of the thesis (Merriam, 1994). We have chosen to do an interpretive case study since we will illustrate, support or challenge our theories.

Most social research involves both deductive and inductive approaches (Eriksson & Kovalainen, 2010). In our thesis we have used the deductive approach since we used existing theories and research and later the theories were examined against the reality of company consider.

The reason we use an interview as a research method is because it will help us to increase the opportunity to make general assumptions. We feel this gives us an opportunity to conclude things that we could not have done with only secondary sources. The questions that were asked during the interview are based upon the theories about agency and stewardship and can be seen in chapter eight, appendix.

In our analysis we have used eight criteria set by Davis et al., (1997) in our aim to compare against the empiric. This article by Davis et al., (1997) is relevant for our thesis since he describes in detail in what situations the stewardship theory could be fulfilled in practice. This is the main reason we chose to use this analysis model. The eight criteria he points out will help us to answer our first research question. The second research question will be answered through the theory of contracting and by information from the interview.

2.2 Collection of data

In our collection of information we have used both primary and secondary sources. The primary source comes from data that we have collected from the originating source and that has not existed before. The primary source we used is the interview. We have interviewed Per Stenman, one of two investment managers at Chalmers Innovation Seed Fund, (which is an incubator under Chalmers Innovation) as well as CEO at Chalmers Innovation Affiliate Fund a contributor to the Chalmers Innovation Seed Fund. Chalmers Innovation Seed Fund is a venture capital fund located in Gothenburg. The reason we only chose to interview Per Stenman is based upon four criteria:

- The person of interest must work as an investment manager in order to know how the investment process works;
- The person of interest must have worked at least four years as an investment manager in order to be knowledgeable;
- The person of interest must have direct contact with the entrepreneurs in order to fully understand the relationship; and
- The person if interest must be available for interview during December 2012.

Per Stenman fulfills all four criteria and is therefore a suitable candidate for our thesis. He works as an investment manager at Chalmers Innovation and before his current employment he worked at Sätila Holding AB as an investment manager for four years, which also is a venture capital firm. Stenman meets the entrepreneurs himself, and is a part of every step from screening to post-investment activities. He was also available for interview in December 2012.

Our secondary sources consist of literature, articles, theories and previous works that we have found in the Library of Economics in Gothenburg as well as on their website with related databases such Business Source Premier, Journal Storage and Emerald. Some of the keywords used in our research are *agency theory AND/OR venture capital, stewardship theory AND/OR venture capital, empowerment, venture capitalist entrepreneur relationship and asymmetric* *information*. In some cases we have also used the Swedish Private Equity & Venture Capital Association website and Chalmers Innovation's official website.

2.3 Reliability and validity

The reliability is determined by how the measurements have been performed and how accurate we have been when we collected our information. Validity is determined of what we measure and how we have described it in the framing of our question (Eriksson & Kovalainen, 2010).

Our thesis aims to have as high reliability and validity as possible, though we know that difficulties could occur. The problem we can predict is the treatment of primary source in our case the interview. We are well aware of when interviewing, the information is always biased. To try to reduce this issue we will ask follow-up questions and be critical of the responses we receive. Since Chalmers Innovation is outspokenly profit driven, as most other venture capitalist firms (Landström, 2007) we consider their way of working as a common pattern among the venture capital field and therefore we argue that one interview with Per Stenman is sufficient to withhold the legitimacy of our thesis. Furthermore, we recorded the interview so that we would not miss any information. The scientific articles and literature used as secondary sources in our thesis are exclusively acquired at the Library of Economics at University of Gothenburg as well as their website.

3. Theoretical background

3.1 Agency theory

Eisenhardt (1989) describes the agency theory as a result of the explored risk sharing among individuals and groups during 1960-1970. The problem found was when two cooperating parties have different attitudes toward risk and thus have different objectives in mind. The starting point of agency theory is the relationship between the principal who delegates work to an agent who perform the work: this is also called principal-agency problem. The agency problem arises because the agent seeks to maximize its own utility and it is costly and difficult for the principal to observe the agents work. Therefore it can be assumed that the agent will act in his or her own interest rather than the principal's (Bender, 2011). There are two aspects of the agency problem: first is adverse selection, which is the aspect when the agent claims to have certain skills when hired. This becomes a problem because the principal cannot verify the skills before hiring or when the agent is working. The second aspect is moral hazard which refers to lack of effort from the agent. This is the aspect in which the agent does not do what he promised from the beginning.

The cost that agency problem generates is called agency costs (Jones 2004). These costs consist of monitoring cost by the principal, bonding cost by the agent and residual loss of economic welfare (Bender, 2011). Two ways to reduce the agency costs are to have reward schemes and to make changes in organizational structure that contributes to the agent to act in the principal's interest rather than the interest of itself (Jones 2004). Usually there is a contract regarding compensation to the agent for performing the principal's work. The amount of utility that the agent perceives depends both on the compensation defined in the contract and the value of the action that the agent has chosen (Bender, 2011).

Eisenhardt (1989) presented several propositions about the agency theory, but first we will define two concepts of contracts. First is behavior based contract in which the principal is investigating the agent's work with the help of information systems like reporting procedures and holding a place in the board of directors. Second is outcome based contracts that should motivate the behavior of the agent to be in line with the principal's preferences and transfer the risk to the agent.

Proposition one: *"When the contract between the principal and the agent is outcome-based, the agent is more likely to behave in the interest of the principal."*

(Eisenhardt, 1989, p. 60)

Proposition two:*"When the principal has information to verify the agent behavior, the agent is more likely to behave in the interests of the principal."*

(Eisenhardt, 1989, p. 60)

The motives behind the agency theory are the balance between the cost of measuring behavior and the cost of measuring the outcomes and therefore transferring the risk to the agent (Eisenhardt, 1989).

3.1.1 Applied Agency theory in venture capital financing

One difficulty that will arise between these two parties is the asymmetric information. The entrepreneur may have information about their idea that they might not share with the venture capitalist or conversely. Asymmetric information is related with the two concepts mentioned earlier, adverse selection and moral hazard. Adverse selection is correlated to pre-contractual asymmetric information and is concealed information from the entrepreneur that could contribute to bad investments for the venture capitalist. Moral hazard is correlated to post-contractual asymmetric information and is the possible risk that the entrepreneur does not act for the venture capitalist's benefit or may have hidden intention. The problem of hidden intention arises because of too complex or incomplete financial contracts (Isaksson, 2006, Bender, 2011) and this may lead to negative effects in terms of shortsighted behavior (Smith, 2010). Below in figure 4, you can see the three different types of information asymmetry divided into pre- and post-contractual.

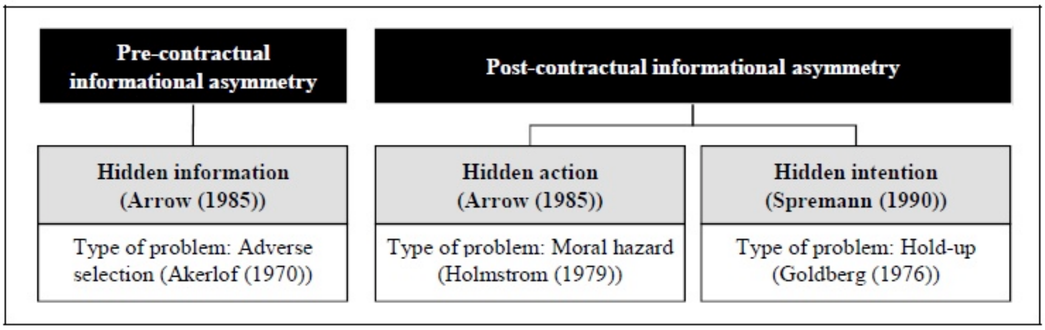

Figure 4 *Different types of asymmetric information within the Agency theory (Bender, 2011)*

3.2 Stewardship theory

The basic idea behind the stewardship theory is that it states humans to be in greater needs than the neo-classical view in the sense of them to be opportunistic, untrustworthy and focused on personal gains. Therefore, it is considered that the manager's behavior is organization centered (Arthurs & Busenitz, 2003), whose main aim is to improve the organizations performance by satisfying its principals. The theory tries to identify the situation where both the principal and the steward are aligned. Its utility is maximized when the stewards' goals are coordinated with the principals' (Arthurs & Busenitz, 2003). Because of this situation this theory lacks the ability to explain behavior before a venture capitalist has chosen to invest in a certain portfolio, because the goals have not yet been set. The theory accepts that agents are opportunistic but that human motives are more than just self-actualization. Therefore, agents that are driven by organizational and collectivistic motives have a higher utility by aiming for goals that are the best for the business which often align with the interest of its principal (Bender, 2011).

Further, the stewardship theory states that monitoring and controls that are proposed by the agency theory interfere with the motivation of the steward. This could lead to a loss of productivity and incite opportunistic behavior. Since there is no conflict between the principal and the steward, the theory suggests that the agents receive empowerment and autonomy from their principals. This leads to an increase in productivity, and in this form they can create an environment where the agents could proceed effectively (Bender, 2011).

For this theory model to be efficient it is as mentioned above crucial that both the agent and the principal act accordingly to the stewardship model. In the case that both act according to the agency relationship, the result would be a true agency relationship, in which both parties will work try to reach a stewardship relationship in effort to minimize the agency costs. In contrary, if both parties decides for a stewardship relationship, this would be a true stewardship relationship. Here no agency costs occur because the stewards act in the interest of its principal (Bender, 2011).

3.2.1 Applied Stewardship Theory in venture capital financing

Bender (2011) discusses the possibilities for the stewardship theory to be applied on actual venture capital financing. He stresses that the venture capitalist and the entrepreneur could be considered as agents and stewards. Furthermore, he states that if the venture capitalist is considered as a principal, then the entrepreneur should act for the venture capitalist's best interest.

The whole procedure starts before the financial contract is formed and the two parties' interests are not aligned because they are yet unknown to each other. The entrepreneur is interested in promoting his idea and the venture capitalist is just out for a good investment opportunity with high potential return. As the contract negotiation proceeds and business starts, it lies in both parties' interests that the venture succeeds, not only that the entrepreneur considers himself loyal to the venture capitalist. As the entrepreneur arguably sees himself as owner of the venture, this because of the effort and wealth invested he could be seen as a steward. The venture capitalist on the other hand is interested in high returns for its investments and therefore also wants the venture to succeed (Bender, 2011).

3.2.1.1 The venture capitalist as a principal

If the venture proves to be successful, it is very likely that the venture capitalist supports the entrepreneur and his past behavior, which would lead to more autonomy for the entrepreneur to boost the success of the venture. In this situation both the venture capitalist and the entrepreneur will move towards a stewardship relationship (Bender, 2011).

In the other scenario where the venture would fail to meet the venture capitalists expectations the venture capitalist could react in two different possible ways. Firstly, the venture capitalist might consider the failure of the venture to be based upon problems with the entrepreneur and his lacking ability to act according to the venture capitalists criteria. This would be perceived as opportunistic and driven by self-interest, leading the venture capitalist to increase its control and monitoring. Hence, we are moving towards an agency relationship. Secondly, if the venture capitalist were profit-oriented he would try to exit the venture as soon as possible to be able to save as much time and get as much money as possible. Because the success of the venture is not of importance here it is very unlikely that a stewardship relationship would emerge (Bender, 2011).

Finally, Bender (2011) notes that it is very likely that a mutual stewardship relationship would not be able to persist because the venture capitalist would maybe prefer to act differently at different parts of the investment period.

3.2.1.2 The entrepreneur as a principal

In the case the entrepreneur acts as a principal, the venture capitalist would act like a steward caused by high interest in a successful venture and therefore supporting the entrepreneur. The venture capitalist's stance would continue as the venture continues to develop and with a successful outcome it is up to the entrepreneur to decide whether to have an agency or stewardship relationship towards the venture capitalist. If the entrepreneur chooses to have a stewardship position, they would have to give the venture capitalist more autonomy and give them the right to come with advice and also provide information about the venture to please the venture capitalist. This could therefore lead to a true stewardship relationship. In case the entrepreneur does not show any interest in the venture capitalist other than just the financial investment the venture capitalists support may decline and start acting like an agent instead. According to Bender, this is unlikely to happen since the entrepreneur relies on the support from the venture capitalist and the provision of information normally is stipulated by the financial contract (Bender, 2011).

3.3 Dimensional comparison of agency theory and stewardship theory

Having discussed both agency theory and stewardship theory, there are a number of dimensions that could be set up to differentiate them. These dimensions could be outlined broadly as psychological and situational (Davis et al., 1997). The first dimension, which is the psychological one, includes factors such as motivation, identification and use of power. While the other dimension, being situational, includes management philosophy, culture and power distance. We will in this section discuss the difference between agency theory and stewardship theory based upon their findings and finally set up a number of criteria on when the different theories take effect, which are derived from the different factors given.

The core difference between agency and stewardship theory in the light of psychological factors have been discussed in the debate of the *"model of man"* which is defined by the theory of a rational individual that would seek to maximize his individual utility (Jensen & Meckling, 1976). Here both the agent and the principal would seek to gain as much utility possible at the lowest expenditure (Davis et al., 1997). The agency theory states that the man is deeply rooted in an economic rational behavior thus would behave opportunisticly if the situation would arise. This view has been challenged by Argyris (1973a) by stating that the human behavior is more complex and should the model of man should be revised to be more accurate. To meet the problem put forward by Argyris (1973a), he argued for a *"self-actualizing man"* that is based on McGregor (1960) and also Maslow (1970). In his model, humans have the need to grow beyond their current state and reach a higher level of achievement and that the focus on the economic man would limit people from self-actualizing themselves and would suppress their level of aspiration (Davis et al., 1997). Finally, Argyris (1973a) meant that when not being able to suppress their aspiration, people would be frustrated with the organizational structure, therefore leading to negative behavior. Davis et al. (1997) concluded that the model set by Argyris (1973a) is essentially the model of stewardship theory and the main differences between agency and stewardship theory can be based on the arguments on the differences between the economic and self-actualized man.

First of the psychological factors is motivation; here we have extrinsic versus intrinsic motivations. In agency theory, tangible exchangeable goods that are measured in market value motivate people, which could be different reward systems that then can be valued in terms of money. As mentioned earlier, the stewardship theory implies that people would be motivated to work for the best of the organization they exist in therefore, intrinsic motivations such as opportunity for growth, achievement, and affiliation, are not so easily quantified and therefore also harder to control and ordinate from the principal's point of view. Another view on intrinsic motivation is the one by Manz (1986) that modeled a theory of self-leadership. Manz (1986) meant that self-leadership would lead individuals towards naturally motivated tasks but also being able to manage tasks that have to be done but not necessarily motivating (David et al., 1997). Terms like self-determination, self-efficacy and the feeling of purpose are meant to be vital to explain the intrinsic motivation. Self-leadership means that the belief in one's purpose and work, as well as having a shared organizational goal, goes further beyond the formal reward system.

Criteria one: "*People who are motivated by higher order needs are more likely to become stewards in principal-steward relationships than are people who are not motivated by higher order needs."*

(Davis et al., 1997 p. 29)

Criteria two: ***"****People who are motivated by intrinsic factors are more likely to become stewards in principal-steward relationships than are people who are motivated by extrinsic factors.*

(Davis et al., 1997 p. 29)

The second factor discussed by Davis et al. (1997) is identification, and is defined by when managers identify themselves as members in a organization by accepting its mission, vision and objectives (Kelman, 1958, Mael & Ashforth, 1992), gaining satisfying relationships (O'Reilly, 1989; Sussman & Vecchio, 1982). With identifying oneself with the organization, the organization is meant to become an extension of the steward's psychological structure (Brown, 1969). By identification the manager would take credit for success and feel frustration with failures made by the organization (Katz & Kahn, 1978). Since success for the organization is seen as success for the manager, this would boost the satisfaction for the individual. However managers that fall within the agency theory would not identify themselves with the organization and try to avoid blame for organizational failure and when they try to distance themselves from the organization's problems to be worsened because bad decisions could be made (D'Aveni & Macmillan, 1990). Identification with the organization is crucial for engaging in cooperative, altruistic behavior (Davis et al., 1997). Thus, they would work for the best of the organization. Furthermore, a related concept called organizational commitment, which is defined by Porter et al. (1974) as *"the strength of the individual's identification with and involvement in a particular organization"* (Davis et al, 1997 p. 30). Mayer and Schoorman (1992) defined organizational commitment as a multidimensional construct made by ongoing commitment, with the desire to remain in the organization. Value commitment is the *"belief and acceptance of the goals of the organization"* (Davis et al, 1997 p. 30), and this is seen as a vital part of the steward. In contrast, value commitment would not have any economic utility in the agency theory.

Criteria three: ***"****People who have high identification with the organization are more likely to become stewards in principal-steward relationships than are people who have low identification with the organization."*

(Davis et al., 1997 p. 30)

Criteria four: **"***People who are high in value commitment are more likely to become stewards in principal-steward than are people who are low in value commitment."*

(Davis et al., 1997 p. 30)

Lastly in the psychological dimension is the use of power. It is meant that managers receive satisfaction from the use of power and are therefore motivated by it (McClelland, 1975, McClelland & Burnham, 1976). The power motive is defined by McClelland and Burnham (1976) as the need to influence others to achieve organizational goals. Two types of power are defined, these being institutional power and personal power (Davis et al., 1997). Where institutional power means that the principal exert control based on its position in the organization, by identification of the principal to the organization would as mentioned earlier provide a membership to the organization which will terminate the institutional power. Further, Davis et al. (1997) argues that coercive legitimate and reward power could be seen as institutional power. Finally the use of institutional power is typical within the principal-agent relationship in the light of agency theory. While institutional power is based on an individual's position, personal power is not, instead it based on intrinsic abilities and interpersonal relationships. Furthermore, Davis et al. (1997) explains that expert and referent power are typical for personal power where referent power is created through identification between individuals. This type of power is not affected by organizational structure and formality. The creation of personal power is time consuming but when achieved it can be sustained over a long period of time. For the principal-steward relationship within the stewardship theory, personal power is vital.

Criteria five: **"***People who are more likely to use personal power as a basis for influencing others are more likely to become stewards in principal-steward relation-ships than are people who use institutional power."*

(Davis et al., 1997 p. 32)

The other dimension is situational dimension; here we will discuss factors such as management philosophy that introduces terms as control-oriented and involvement-oriented a management philosophy that states the separation between thinking, controlling and doing in an organization. While the cultural factor explains the difference between individualistic and collectivist behavior of individuals within an organization and their ability to cooperate and how they value common goals over individual ones, lastly is the power distance factor that outlines the fact of how individuals accept inequality in power between members of an organization (Davis et al., 1997).

Based on the earlier discussion on the model of man, Argyris (1973a) argued for a management philosophy that was based on economic assumptions that would lead to a self-fulfilled prophecy on the nature of relationships (Argyris, 1973a, b). He meant that the use of normative models of organization based on self-actualization would develop a stewardship relationship. Later, Walton (1985) defined a theory what he called for high-commitment management philosophy, which was characterized by a high degree of participation and communication, empowerment of workers and trust. This theory was later extended by Lawler (1986) where he contrasted a control-oriented versus an involvement-oriented management philosophy. In the control-oriented philosophy, the core is set by the concept that thinking and controlling should be separated from the doing part of the work, while the involvement-oriented philosophy puts forward ideas as self-control and self-management where no separation between the thinking, controlling and doing is being done. Further, Lawler (1986) argued that in an uncertain environment with high labor costs and focus on long-term effectiveness, the involvement-oriented approach keeps an advantage over the control-oriented philosophy. Mayer et al. (1995) defined trust as the *"willingness to be vulnerable in the context of a relationship"* (Davis et al., 1997 p. 33). The need of trust is avoided in the control-oriented approach while it is a critical part in the involvement-oriented philosophy; it occurs in the interpersonal sphere, hence it is a base for the creation of personal power (Davis et al., 1997). Since control-oriented relationships are normally transactional or are based on institutional power the need of trust is not so prevailing. Finally, Davis et al. (1997) argues that an involvement-oriented management philosophy creates a principal-stewardship relationship based on the stewardship theory, while the control-oriented management philosophy sets ground in the agency theory.

Criteria six: "*People who are in an involvement-oriented situation are more likely to become stewards in principal-steward relationships than are people who are in a control-oriented situation."*

(Davis et al., 1997 p. 34)

The cultural factor influences whether people would be in agency or stewardship relationships, based upon Hofstede's (1980, 1991) dimension of individualism-collectivism, where individualism is defined as the importance of personal goals over group goals, while collectivism puts the group's goal as a primary objective. Thus in collectivistic behavior confrontation and conflicts are rare, the individuals identify themselves as members of the organization and success is attributed to the whole organization. Individualistic behavior however sees confrontation as a mere necessity to solve problems. Since collectivistic behavior sees the building of mutual relationship as crucial, it is very time consuming. On the other hand, an individualist would use swifter methods and minimize potential risks with contracts. Based on these assumptions a collectivistic behavior would lead to a stewardship relationship while the individualistic would lead to an agency relationship.

Criteria seven: ***"****People in a collectivist culture are more likely to develop principal-steward relationships than are people who are in an individualistic culture."*

(Davis et al., 1997 p. 35)

Finally, power distance is another dimension by Hofstede (1980, 1991) and is defined as *"the extent to which less powerful members of institutions and organizations within a country expect and accept that power is distributed unequally"* (Davis et al., 1997 p. 35). Some cultures accept large differences between members of an organization where less powerful members are supposed to be dependent on members with more power. Others do not accept the power distance and inequalities are minimized (Davis et al., 1997). In the context of organizations and its individuals, high power distance in organizations is characterized by centralization, differences in authority, and privileges, while in low power distance organizations the opposite occurs and the organization is characterized by decentralization and high involvement in decision-making. High power distance is prevalent in principal-agent relationships according to the agency theory. This is because of the creation of hierarchies and supervision by the principals. On the other hand a low power distance culture would lead to a stewardship relationship since individuals feel like equal members of the organization and work toward the same goals (Davis et al., 1997)

Criteria eight: ***"****People in a low power distance culture are more likely to develop principal-steward relationships than are people who are in a high power distance culture."*

(Davis et al., 1997 p. 36)

A comparison between agency theory and stewardship theory based upon the different dimensions is seen in table 1.

Comparison of Agency Theory and Stewardship Theory

	Agency Theory	Stewardship Theory
Model of Man	Economic man	Self-actualizing man
Behavior	Self-serving	Collective serving
Psychological Mechanisms		
Motivation	Lower order/economic needs (physiological, security, economic)	Higher order needs (growth, achievement, self-actualization)
	Extrinsic	Intrinsic
Social Comparison	Other managers	Principal
Identification	Low value commitment	High value commitment
Power	Institutional (legitimate, coercive, reward)	Personal (expert, referent)
Situational Mechanisms		
Management Philosophy	Conrol oriented	Involvement oriented
Risk orientation	Control mechanisms	Trust
Time frame	Short term	Long Term
Objective	Cost control	Performance Enhancement
Cultural Differences	Individualism	Collectivism
	High power distance	Low power distance

Table 1 ***Comparison of agency theory and stewardship theory (Davis et al., 1997)***

3.4 Contracting

The contracting phrase is a crucial part for the relationship between the venture capitalist and the entrepreneur to even emerge. The contracts are used to avoid principal-agency problems and reduce agency costs. The agency cost arises because of asymmetric information and conflicts of interest: this is why the relation needs to be regulated in contracts (Bender, 2011).

Negotiating a contract between the venture capitalist and the entrepreneur involves an exchange of benefits, because both parties seek to optimize their own position. Though, the venture capitalist has the final say, since they usually have more experience of contracting. Furthermore, the contracting phase is all about building long-term relationships between the parties and most of the parts of the contracts are to avoid potential agency problems and protect the venture capital firms against adverse selection and moral hazard (Isaksson et al, 2004).

Kaplan and Strömberg (2001) wrote an article concerning the principal-agent problem in financial contracting and thus the relationship between contracting, screening, and monitoring in venture capital firms and the entrepreneurs. In theory there are several possibilities for the principal to reduce these problems concerning asymmetric information. First, the principal could structure a financial contract in order to get the entrepreneur acting in the principal's interest. Secondly, the principal could collect relevant information before investing and thirdly, the principal could participate in monitoring the entrepreneur during the project. The authors argue that the three activities are related and dependent on each other. According to Smith (2010) contracting could generate a negative effect, since it might encourage shortsighted behavior of the entrepreneur because later round investments are conditional.

Regarding contracting Kaplan and Strömberg (2001) found that voting rights, board rights and liquidation rights was contracted so that if the venture performed badly the venture capitalist would gain full control of the company, and as the venture improved their performance the venture capitalist would reduce their participation. Additionally, the authors found that it is common to contract a competition clause in order to make it expensive for the entrepreneur to leave the firm.

Before taking on the investment and establishing the financial contract, the venture capitalist spends enormous amounts of time in evaluating and screening their investments opportunities. The management risk is the most frequent source of uncertainty that the venture capitalist identifies. This is why the venture capitalist usually identifies a need of carrying out the management team with its own qualified experts. Furthermore, they found that when evaluating the different risk factors, management risk is the factor that affects the construction of the financial contract the most, thus when increased management risk occurs the venture capitalist ensures that they have a higher degree of control in the venture. The conclusion of this is that ventures who have strong management teams are more likely to become listed and successful (Kaplan & Strömberg, 2001).

The post-investment activities concern the monitoring of the venture by the venture capitalist. Kaplan and Strömberg (2001) found that in 14 percent of the investments, the venture capitalist plays an important role in ensuring that the company has the right management team before investing and 50 percent of the ventures expect that the venture capitalist have an active role in the elaboration of the management team after the investment. Furthermore, more than one in three ventures expects the venture capitalist to participate in more areas like developing business plans and developing strategic relationships with other companies. Despite this evidences that the entrepreneurs would like to be supported, it can be seen that the venture capitalists only want to support them to a certain limit. This is because of the risk of high monitoring costs as well as involvement costs. Implication of this is that the venture capitalists do have a monitoring and advisory role, but they do not intend to become too involved.

Isaksson et al (2004) made a study of 35 Swedish venture capital companies and what characteristics the contracts between the entrepreneur and the venture capital firm have. The questionnaire sent to the venture capital firms consisted of 79 contractual covenants which were divided into five categories: pre-investment agreements, ownership and management, post-investment relationship management, specific events in the post-investment period and last exit. Of the 79 covenants examined, 42 of them were used almost always by more than 50 percent of the firms and the ten covenants used by over 90 percent are showed in table 2 below.

Most commonly used contractual covenants.

Contractual covenants	Firms 'almost always' using the term (%)
Specified ownership of properties and assets	96
No legal actions outstanding against the firm	96
A specified structure for the deal between the venture capitalists and the entrepreneur	96
No off-balance sheet liabilities	93
Patent rights/ownership of patents	93
Arbitration clause	93
Specified rules governing the decision-making power of the board of directors	93
Specified rights to nominate board members	93
Specified rights to attend board meetings	93
A non-competition clause/loyalty clause imposed on the entrepreneur in the event of his/her departure from the venture	93

Table 2 ***Most commonly used contractual covenants with over 90 % in using rate (Isaksson et al, 2004)***

The five first items listed in table 2 are related to the category ownership and management and the last four listed are related to the category post-investment relationship management. Many of these covenants are standardized in investment contracts and are not only used in the venture capital industry. Though, the four last listed in table 1 consider being boilerplate in the Swedish venture capital contracts.

Only ten out of 79 covenants were seldom used by 50 percent of the venture capital firms. These ten covenants can be seen in table 3 below, but worth mentioning is that the first three with the highest least used percent are those covenants that give the entrepreneur some benefit, no other covenants contribute to the same level of advantage as the three first in table 3 (Isaksson et al, 2004).

Least commonly used contractual covenants.

Contractual covenants	Firms 'seldom' using the term (%)
Minimum time in which assistance was to be provided by the venture capital firm	93
Agreement to sell out the totality of shares if returns exceeded a pre-specified level	89
Buy out rights for entrepreneur	85
Specific dividend agreements	74
Exclusivity clause (VC)	67
Put option for VC if no exit	63
Insist on entrepreneur(s) having own lawyer	63
VC has to sign when company commits itself to external partner	63
VC has power to dismiss CEO	59
Drag along rights	59

Table 3 ***Least commonly used contractual covenants (Isaksson et al, 2004)***

4. Empirical data

4.1 Chalmers Innovation

In the mid-90s there arose a demand for a business incubator from Chalmers University of Gothenburg. This made the initiated of a search for funding. The breakthrough came in 1997 when Stena shipping company donated 51 MSEK, and this was the startup of Chalmers Innovation. Chalmers innovation is a pure venture capital fund that is extremely return intensive. They only invest in technological ideas, but in their portfolio there is everything from nanotechnology to apps. The likelihood of being accepted as an entrepreneur is greater if you are a researcher (11 percent) but only 2,9 percent if you are a student and 4 percent if you are an innovator, these numbers are in line with the principles' of Chalmers Innovations goals and objectives (Chalmers Innovation, Stenman, 2012).

Between 1999 and yearend 2010/2011 the company has been involved in starting 102 companies. Of the 102 startups there are 75 of them still alive and evolving; this gives them a success rate of 73, 5 percent, which is a relatively high figure. In the year of 2010 the portfolio companies had a total turnover of 415 million SEK and 415 employees. Chalmers Innovation have over the years invested more than 1,37 billion SEK in their portfolio companies which makes them the leading idea investor and business incubator in Sweden (Chalmers Innovation, Stenman, 2012).

4.2 Summery of interview

Their screening process is the building block to avoid bad investments. When an entrepreneur has an idea they want money for, first Chalmers Innovation and the entrepreneur sign an agreement called term sheet. This agreement describes that they now focus each other, the venture will not look for any new ideas and the entrepreneur will not seek other investors. In this agreement they do not promise to invest, the agreement only controls the confidentiality. When this is signed, Chalmers Innovation will follow the entrepreneur for a period. Stenman (2012) called this "dating", they want to get to know the person behind the idea better, to ensure that they are dedicated enough to make their idea successful. He continues with the idea that the time factor is an important part, and that later they discuss their candidate with existing owners and prospective. This dating period is from six to twelve months before they decide to invest and there is an 80/20-rule, 80 percent getting to know the entrepreneur and 20 percent researching about the idea.

It is very rare that negative information about the entrepreneur's idea arises. Stenman (2012) says there are very few occasions that the entrepreneur actively withheld information. The problem usually lies at the human level where the entrepreneur is not dedicated enough when things do not go as planned. Furthermore, he says there is maximum five percent of the investment that comes with unexpected problems. When disputes occur, there are shareholder agreements that regulate what will happen. This type of agreement is signed together with the investment agreement when investing in the entrepreneur. The reason why there are so few investments that come with negative information is because of the extensive screening process. Furthermore, if the collaboration has started to experience problems it usually never works out because the relationship between the entrepreneur and the venture capitalist is the foundation of the venture.

The contracting phase consists of the three different agreements mentioned above: the term sheet; the investment agreement, which regulates concrete financial amounts and payments; and the shareholder agreement, which regulates the form of ownership. When signing a new portfolio company there is a basic contract that adjusts after what kind of case they are handling. They need to identify the value drivers of the entrepreneur's idea and this will then be written into the contract. In the contract there is a competition clause that is extremely regulated. Because the venture capitalist invests in the entrepreneurs as individuals, a lack of cooperation from the entrepreneur's side would lead to an extreme value loss for the venture capitalist. With the shareholder agreement the possibility for the entrepreneur to leave the investor is avoided, the entrepreneur is neither allowed to start competing cases or bring ideas somewhere else.

These potential problems cannot be operated by liquidated damages because they are private persons, but can only be controlled by regulation of the entrepreneur's shares. There are also buyout clauses that regulate if either the venture capitalist or the entrepreneur wants to leave the company. In the basic contract there is a paragraph that regulates that the venture capitalist is allowed to sell off the portfolio company if they find it is the right time to do so even if the entrepreneur do not approve.

When the two parties start their cooperation, the venture capitalist and the entrepreneur both owns 20-40 percent of the venture, with the other owners being employees and board members among others. It is very rare that the entrepreneur or the venture capitalist has a majority by themselves and it is also written in the contract that none of the parties are allowed to have a share majority. If the entrepreneurs have majority because they have contributed with their own money, then this will be written in the contract so the venture capitalist have a protection against the majority.

It is very rare that the contract consists of specific veto rights for the venture capitalist. Stenman (2012) believes that if the contracts are too regulated, this will have a negative impact on the entrepreneurs' creativity, inspiration and momentum. The contracts should be specific but not too specific so that the entrepreneur does not want to pursue his or her idea. The contract is of high importance to have when something does not go as planned, but nine out of ten times the contracts are only stored in filing cabinets. When a portfolio company is exiting, then the contract can be studied to see specific details.

Later on when the two parties have made an agreement, the monitoring process begins. The first thing that Chalmers Innovation does in their portfolio company is to take an active role in the board of directors. They also require reporting in terms of economy and sales tracking in order to see that the entrepreneur follows their goals. To reduce the risk that could occur, it is clearly defined what the entrepreneur should do in advance. The shareholder agreement controls the quarterly goals and the product development and is usually connected to the investment agreement. Some portfolio companies also have tranche agreements that consist of money that they get in different intervals; if the entrepreneur does not comply with the venture capitalist when cooperating they will not get more money from later payments.

Meetings between the venture capitalist and all of the portfolio companies take place on a weekly basis but in different periods where they do reconciliations. If the portfolio company is very transaction-intensive there is a need for more meetings. If the portfolio company is not in need of more money but works to optimize growth, then meeting once a month is enough. Thus, depending on the type of company, different types of contact is required.

The entrepreneur is expected to operate the company by themself, but when corporate strategic decisions at board level occur the venture capitalist wants to be involved and control the decisions. Even though the entrepreneur should run the company by themselves, the venture capitalist contributes to the everyday work. These contributions are in terms of network; clients, new board members, and development of business plan and bringing similar companies together so that they come in contact with each other.

The need of control from the venture capitalist is at about the same level throughout the corporation. Stenman (2012) continues with when the portfolio company improves, the need of control is even bigger since then it is easy for the portfolio company to soar away.

5. Analysis

5.1.1 Analysis of stewardship and agency theory in practice

The starting point of the agency theory is the principal-agency problem that arises because the agent seeks to maximize its own utility rather than working together with the principal. As mentioned in the empirics this could be perceived as not true in reality. The entrepreneur seeks funding from a venture capitalist to make his idea real and without the funding the entrepreneur would never have the possibility to realize his or her dreams; therefore the entrepreneur and the venture capitalist will work as a team.

In his book Bender (2011) discusses the possibility of the venture capitalist and the entrepreneur to shift between the agency and stewardship theory. With success of the venture the venture capitalist would loosen up the grip around the entrepreneur and hence a move toward the stewardship relationship is being made. But when a failure has occurred the venture capitalist would increase the control over the entrepreneur. Stenman (2012) objected to the idea that the venture capitalist would decrease the control with success; in contrary, higher control should be made so that the entrepreneur would stick to the set plans.

Further, Bender (2011) concludes the possibility of the entrepreneur to take the role as a principal; this is met with a high distrust in practice according to Bender. This distrust is due to the entrepreneur is in the need of the financial support of the venture capitalist. Therefore, they are most often forced to oblige with demands set by the venture capitalists.

One of the core problems in the stewardship theory is the level of empowerment normally given from the venture capitalist to the entrepreneur. It states that with a higher level of empowerment the productivity will be higher thus generating a long-term profit. In practice this is realized with the help of the extensive screening process and thus is the problem of adverse selection handled. The screening process is the most important part of the investment process since it will reduce the risk of potential bad investments. Stenman (2012) explains that the screening phase is the building block in their investments. In this phase they get to know the entrepreneur discern whether the entrepreneur is dedicated enough to make a good corporation. The proportion of investments in portfolio companies in which the entrepreneur has actively withheld information is only five percent; the reason for the low percentage is because the venture capitalist, through the screening process eliminates, the risk of adverse selection.

Stenman (2012) explains that contracting reduces the problem of moral hazard. By the extensive screening phase and contracting process there should not be any agency costs. A requirement of the venture capitalist to accept the entrepreneur's idea is to take place in the board of directors of the portfolio company. Furthermore, there are no reward schemes for the entrepreneur, but it is their ownership that gives them value. The risk that the entrepreneur does not act for the venture capitalist's benefit or has concealed intention is in reality not a risk since this is regulated in the contract. If we are to put the contract into one of the two categories Eisenhardt (1989) described, they belong with the behavior-based contracts since Chalmers Innovation requires reports from their entrepreneurs so that they can follow up. They also take place in the board of directors from the beginning of their corporation. As the author said in proposition two, Chalmers Innovation has information to verify the agent behavior, and thus it is more likely that the agent behaves in the interest of the principal otherwise the venture capitalist will leave their corporation.

Given the fact that at Chalmers Innovation they rather hold the entrepreneurs controlled when it goes well is because it is considered easier to drift away from the actual strategy and plan instead of in times when it goes bad for the venture. This also prevents opportunistic behavior and actions made in self-interest from either part. Conflicts are very uncommon because of all these measures taken and the prevailing feeling of camaraderie (Stenman, 2012).

Because the venture capitalist invests in the entrepreneur as an individual, they lock them in with rigorous contracts, which makes it hard for the entrepreneur to leave the corporation; but entrepreneurs however should not feel hindered from pursuing their ideas because of by economic boundaries, and the entrepreneurs are expected to operate and manage the portfolio company by themselves. Although the contracts are precise, according to Stenman (2012), they try not to make them too strict; for example, in decision-making, they exclude specific vetoes, so neither can take precedence over the other.

At the board-level the venture capitalist wants to be able to influence the decision-making, but since the entrepreneur is scrutinized before an investment is made their goals most often do align. In this sense Chalmers Innovation empowers the portfolio companies and its entrepreneurs from the very beginning. The stewardship theory implies that monitoring and control mechanisms would decrease the productivity of the portfolio company based on the reason that this would interfere with the entrepreneurs' ideas and creativity.

5.1.2 Analysis of the role of the contracting

Of Isaksson's et al (2004) ten most commonly used contractual covenants, Chalmers Innovation is using all ten mentioned. The first one concerning the ownership is specified in the shareholder agreement. The next is related to legal actions outside the firm, which are not allowed without the venture capitalist's approval. As Stenman (2012) mentioned earlier, the entrepreneur is not allowed to bring ideas somewhere else and therefore there is also a non-competition clause regulated in their contracts. Furthermore, there is a specified structure for the deal since there is a contract that regulates the relationship between the parties and the entrepreneur is not allowed to take on liabilities without the venture capitalist's approval. The venture capital firm owns the patent rights for the idea since it is their money, but this is usually not a problem because of a mutual understanding and cooperation. The patent right goes hand in hand with the arbitration clause if the two parties will not get along and the entrepreneur want to get out of the deal. Since the entrepreneur usually does not have the financial strength, the only thing the venture capitalist can take as insurance are shares and thus the entrepreneurs will lose their shares. When Chalmers Innovation starts cooperation with an entrepreneur they always join the board of directors and have therefore have specific rights to attend meetings. They have the casting voice in matters of decision-making where the two parties are not consistent.

Of Isaksson's et al (2004) ten least commonly used contractual covenants, three are used by Chalmers Innovation. The first one is agreement to sell out the totality of shares if returns exceeded a pre-specified level. If the venture capitalist thinks it is the right time to sell off the venture, then they can do it even if the entrepreneur does not agree. Second is the buyout right for the entrepreneur, which the venture capitalist also has. Last is the exclusivity clause, which dictates that the entrepreneur is not allowed to make similar contracts with a third party or start competing business. Worth mentioning is that the first two of these three covenants used are those covenants of all 79 used in the article (Isaksson et al, 2004) that gives the entrepreneur some benefit in relation to the venture capitalist. As a conclusion of this, Chalmers Innovation has an interest in giving their entrepreneurs some advantages in their collaboration in order to make them feel solidarity.

The contracting phase is an important part of the collaboration in order to avoid asymmetric information. The contracts are used to avoid the problems of agency theory and thus the relationship between the venture capitalist and the entrepreneur will be more principal-stewardship related; in the event of disagreements and problems in the relation the venture capitalist has the ability and will have final say in using the contracted covenants to their advantage.

Continuing with the eight criteria mentioned earlier, the first criterion "*Higher order needs*" assesses the determination of a higher need by the individual that goes further than just personal gain. They become motivated by goods that are not just connected to their own position and well-being, but also see other subjects that could have any possible gain of a good. In other words, an individual who sees a satisfaction and motivation as the common good for the whole organization would work towards a stewardship-relationship. In the case of Chalmers Innovation, Stenman (2012) states that they assume that the entrepreneur would work hard on his or her idea and would subsequently give them the appropriate tools to work self-sufficiently. With the extensive screening process they are able to determine if the entrepreneur is dedicated enough to their idea and will work hard to be successful. The entrepreneur thus becomes motivated by a higher need, and with the possibility to realize their idea and become successful, also brings satisfaction for the venture capitalist. Therefore, we would say that they fulfill this criterion.

Further, following the assumption that the entrepreneur will be working mostly for themselves on their idea, we can state that they also fulfill the theory outlined by Manz (1986) about self-leadership. This leads the entrepreneur to receive an intrinsic motivation and satisfaction of their work hence also fulfilling criterion two *"intrinsic/extrinsic motivations"*.

The third criterion *"identification"* discusses the ability of an individual to identify his or herself with the organization in which they exist. Since the entrepreneur has the idea they want to realize, and they identify their work and success of the venture as a personal gain, one can argue that the entrepreneur feels a high identification in the process. In the interview, Stenman (2012) states that from the venture capitalist's point of view and the heavy screening process their attitudes towards the entrepreneur and their ideas are aligned. So they would also feel a personal gain with a success of the venture, as expressed in the interview: *"We are all in this together"* (Stenman, 2012). Therefore, we can conclude that both parts feel a high identification to the organization and that this leads to the fulfillment of the third criterion.

"Organizational commitment" is the fourth criterion; it is defined as the strength of identification and involvement within the organization, as discussed earlier in criteria three, since both parts are deeply committed to each other. The Chalmers Innovation sees organizational commitment as a crucial part where the entrepreneur is highly involved in its work, and this is scrutinized through the early screening process, while also opting for regular feed-back from the entrepreneur. The entrepreneur on its part is assessed to be involved on the part of that it is their project. Secondly, Mayer and Schoorman (1992) defined organizational commitment as the desire to remain within the company. Here again one can argue that after the signing of the contract both parts are dependent on each other for the venture to succeed and have no real incitements to leave the venture before the time for an exit is deemed to be beneficial for both parts. Lastly, the belief and acceptance of the goals set for the organization is seen as value commitment and is crucial for a stewardship relationship to evolve. Here the venture capitalist and the entrepreneur together define the goals, firstly through the contract and then regularly through their meetings. This according to Stenman (2012), would lead to a mutual understanding for each other and the goals set. With this we would say that this criterion is also being fulfilled.

The fifth criterion *"use of power"* discusses the different types of power used to influence the other, and are as outlined earlier: institutional power and personal power. It is stated that institutional power is associated with the principal-agency relationship because it gives the individual the ability to exert power through its position. Personal power however, is based on interpersonal relationships, which are built up over a longer period of time. This criterion is a bit more difficult to assess on the real practice, since according to Stenman (2012) he sees the relationship and the trust that is being built between the two parts are crucial for a functioning cooperation. He feels that a too heavy control would harm the creativity and work efficiency of the entrepreneur. No part would hold a majority over the other in terms of shares in the company so that neither of them would be able to override the other. Although with the signing of the contract the venture capitalist maintains several rights over the entrepreneur such as buy-out clauses and the right to exit when they feel that the time is ready. Even though the rights stipulated in the contract are almost never being used, they still exist (Stenman, 2012). This could be interpreted as an exertion of institutional power since it is based on the venture capitalists position toward the entrepreneur. Based on these facts we would consider that this criterion is not fully completely fulfilled since the contracts give the venture capitalist an institutional power, even though it most often is not being used.

The different kinds of "*management philosophies",* which is the sixth criterion that are characterized by Lawler (1986) are control-oriented and involvement-oriented. The core difference between them is the separation of the thinking, controlling and doing, where no separation is being made in the involvement-oriented approach. Further, Walton (1985) defined high-commitment management philosophy as a high degree of participation, communication, and empowerment of workers and trust. This goes partly in hand with the earlier criteria where it is seen crucial that the entrepreneur is assumed to be working hard and without much intervention by the venture capitalist, that they both feel committed to each other and have a regular exchange of views and reporting of the actual state of the venture. The screening process minimizes the problems that could arise with trust and commitment from both sides, and therefore only a small percentage of the ventures do fail based on relationship and commitment issues (Stenman, 2012). Therefore this criterion would also be fulfilled.

The seventh criterion, *"culture",* states that the cultural behaviors of the individuals are important for the determination of whether they would work in an agency or stewardship relationship. This causes a collectivistic inclination that evolves through the creation of an interpersonal relationship; in such a relationship confrontation is rare and both sides see the common good as more important than personal gain. This is in contrast to the individualistic behavior, which is more short-term, confrontational and sees personal gain as superior. In the case with Chalmers Innovation, they see that the relationship is key in the ability to have a successful venture, which means that there are rarely arguments between the entrepreneur and the venture capitalist (Stenman, 2012). With the first three criteria being fulfilled, both the entrepreneur and venture capitalist identify themselves to the new venture; its success motivates them, and one could argue that they lean towards a collectivistic behavior, therefore, fulfilling this criterion as well.

The last criterion *"power distance"* is defined by Hofstede (1991) as the acceptance of an unequal distribution of power by less powerful members. In this case it is not very clear where one can place the venture capitalist and entrepreneur based on the study made. This is because several measures are being made to prevent one party from becoming dominant,and to ensure that both parties are being heard when decisions are being made. Although the venture capitalist holds some rights that give them a privileged position in comparison to the entrepreneur, this is still rarely used as mentioned above. Finally, since both parts have their voices heard when the contract is being signed and both feel that they are dependent on each other for the success of the venture and the achievement of goals one could argue that they partly fulfill this criterion.

Below in table 4, you can see a summary of each criterion and the theory that it fulfills.

Criteria	Agency theory	Stewardship theory
1. Higher order needs		✓
2. Intrinsic/extrinsic motivations		✓
3. Identification		✓
4. Organizational commitment		✓
5. Use of power	✓	
6. Management philosophy		✓
7. Culture		✓
8. Power distance	✓	

Table 4 ***Summery of each criterion and the theory that it fulfills***

6. Conclusion

The aim of our thesis was to examine whether the stewardship and agency theories do apply to the relationship between the venture capitalist and the entrepreneur. Furthermore, we aimed to shed a light on the process of how the venture capitalist might prevent undesirable effects during the financing process and. Finally, we explored how they could use contracting as a method to stifle unwanted outcomes.

The complexity of the process caused an overlap in our two research and therefore there we will answer the, in an order slightly different from that presented in chapter 1.2.

Since individuals are seen as rational beings according to the theory of "*the model of man*", they would try to seek to maximize their utility with any given chance. This gives a clear indication that agency theory actually applies to how individuals would act in reality. Since the venture capitalist is well aware of this behavior, which could harm their business and lead to high losses, the venture capitalist commences an extensive screening process, which leads to a rigorous contract. All this is done to avoid the occurrence of asymmetric information. We need to keep in mind, however, that it is still a mutual relationship, and that the venture capital sector would not be able to work without the ideas of the entrepreneur.

We came to the finding that the best relationship between the venture capitalist and the entrepreneur is the one outlined by the stewardship theory; this because no unnecessary agency costs occur, and that problems with distrust and heavy control are rare. We want to argue that the principal-stewardship relationship is the most beneficial for both parties, as since Stenman (2012) expressed a heavy belief in empowering the entrepreneur as to not prevent her or him from restraining their ideas and creativity.

Given that asymmetric information is prevalent with everything else being unchanged, and the venture capitalist is aware of this, the use of contracts between the entrepreneur and venture capitalist is set. The signing of the contract is seen as a mutual acceptance of their roles and finally sets the ground for interdependence. Therefore, we see few of the ventures that do fail because of disagreements, and we determine why it is easier for principal-stewardship relationship to emerge.

Six out of the eight criteria we outlined are being fulfilled in our study with Chalmers Innovation; this indicates for a strong principal-steward relationship, which in the long run is most beneficial for both parties. First, when the contract has been settled and accepted by both parties, they tend to lean toward a principal-stewardship relationship. One can conclude that the contracts are crucial for even having a possibility of reaching the principal-stewardship relationship. Finally, the two criteria that do not completely fulfill the stewardship theory are those that assess the power relationship between the entrepreneur and the venture capitalist. We see this as a sign that even though both parties see mutual understanding and high commitment as important the venture capitalist can be seen as having the final say, protected through the contract. In the real world asymmetric information will always be prevalent and the venture capitalist will always be responsible for the funds they manage. Therefore, they will do everything in their power to reduce this potential problem.

For further research it would be interesting to investigate the entrepreneur's perception of the collaboration as well as interviewing other venture capital firms to see if there are differences in how they work.

7. References

Argryis, C. (1973a) Organization man: Rational and self-actualizing. *Public Administration Review*, Vol. 33 pp. 354-357.

Argryis, C. (1973b) Some limits of rational man organizational theory. *Public Administration Review*, Vol 33, pp. 253-267.

Arthurs, J. D. and Busenitz, L. W. (2003) The Boundaries and Limitations of Agency Theory and Stewardship Theory in the Venture Capitalist/Entrepreneur Relationship. *Entrepreneurship Theory and Practice*, Vol. 28, pp. 145–162.

Bender, M (2011) Spatial Proximity in Venture Capital Financing, A Theoretical and Empirical Analysis of Germany, 1st ed., *Gabler Verlag.*

Brown, M. E. (1969) Identification and some conditions of organizational involvement. *Administrative Science Quarterly*, Vol. 14, pp. 346-355.

D'Aveni, R. A., and MacMillan, I. C. (1990) Crisis and the content of managerial communications: A study of the focus of attention of top managers in surviving and failing firms. *Administrative Science Quarterly*, Vol. 35, pp. 634-657.

Davis J H., Schoorman F. D and Donaldson L (1997) Toward a Stewardship Theory of Management, *The Academy of Management Review* , Vol. 22, No. 1, pp. 20-47, Published by: Academy of Management.

Eisenhardt K M. (1989) Agency Theory: An Assessment and Review, *The Academy of Management Review*, Vol. 14, No. 1, pp. 57-74, Published by: Academy of Management

Eklund N and Sandström V (2009) *Har lågkonjunkturen påverkat möjligheten att få kapital från Venture Capitalbolag?* Bachelor thesis, Gävle: Högskolan i Gävle

Eriksson, Päivi and Kovalainen, Anne (2010) *Qualitative Methods in Business Research*, 1st ed, Sage Publications Ltd.

Hofstede, G. (1980) Culture's consequences: International differences in work-related values. Beverly Hills, *CA: Sage*

Hofstede, G. (1991) *Cultures and organizations: Software of the mind*, London: McGraw-Hill.

Holme, I M and Solvang, B K (1997) *Forskningsmetodik om kvalitativa och kvantitativa metoder*, 2nd ed, Studentlitteratur.

Isaksson, A (2006) *Studies on the venture capital process,* Doctoral dissertation, Umeå: Handelshögskolan vid Umeå universitet.

Isaksson, A, Cornelius, B, Landström, H, and Junghagen, (2004) Institutional theory and contracting in venture capital: the Swedish experience, *Venture Capital*, Vol. 6, No. 1, pp. 47-71, Business Source Premier, EBSCOhost, viewed 28 December 2012.

Jensen, M. C., and Meckling, W. H. (1976) Theory of the firm: Managerial behavior, agency costs and ownership structure. Journal of Financial Economics, 3: 305-360.

Jones T (2004) *Business economics and decision making*, John Wiley & Sons Ltd.

Kaplan S. N. and Strömberg P. (2001) Venture Capitalists as Principals: Contracting, Screening, and Monitoring, *The American Economic Review* , Vol. 91, No. 2, pp. 426-430.

Katz, D., and Kahn, R. L. (1978) *The social psychology of organizations*, 2nd ed. New York: Wiley.

Kelman, H. C. (1958) Compliance, identification, and internalization: Three processes of attitude change, *Journal of Conflict Resolution*, Vol. 2, pp. 51-60.

Landström H (2007) *Handbook of research on venture capital*, 1st ed. Edward Elgar Publishing Limited.

Lawler, E. E. (1986) *High involvement management*, San Francisco: Jossey-Bass.

Mael, F., and Ashforth, B. E. (1992) Alumni and their alma mater: A partial test of the reformulated model of organizational identification, *Journal of Organizational Behavior*, Vol. 13, pp. 103-123.

Manz, C. C. (1986) Self-leadership: Toward an expanded theory of self-influence processes in organizations, *Academy of Management Review*, Vol. 11, pp. 585-600.

Maslow, A. H. (1970) *Motivation and personality*, New York: Harper & Row.

Mayer R. C., Davis J. H. and Schoorman F. D. (1995) An Integrative Model of Organizational Trust, *The Academy of Management Review*, Vol. 20, No. 3, pp. 709-734.

McClelland, D. C., and Burnham, D. H. (1976) Power is the great motivator, *Harvard Business Review*, Vol. 54, No. 2, pp. 100-110.

McClelland, D. C. (1975) *Power: The inner experience*, New York: Irvington.

McGregor, D. (1960) *The human side of the enterprise*, New York: McGraw-Hill.

Merriam Sharan B (1994) *Fallstudien som forskningsmetod*, 1st ed, Studentlitteratur.

O'Reilly, C. (1989) Corporations, culture and commitment: Motivation and social control in organizations, *California Management Review*, Vol.31, No. 4, pp. 9-25.

Porter, L. W., Steers, R. M., Mowday, R. T., and Boulian, P. V. (1974) Organizational commitment, job satisfaction, and turnover among psychiatric technicians, *Journal of Applied Psy-chology*, Vol. 5, pp. 603-609.

Smith Kiholom J (2010) Venture Capital Approaches to Value Creation: Contracting and Deal Structure, *Strat. Change,* Vol. 19, pp. 285–292, published online in Wiley Online Library

Stenman, Per (2012) Investment manager, interview at *Chalmers Innovation* (2012-12-13)

Tyebjee, T. T., and Bruno A. V. (1984) A Model of Venture Capitalist Investment Activity, *Management Science,* Vol. 30, No. 9, pp. 1051–1066.

Walton, R. E. (1985) From control to commitment in the workplace, *Harvard Business Review*, Vol. 63, No. 2, pp. 76-84.

7.1 Websites

Chalmers Innovation, www.chalmersinnovation.se (2012-12-14)

Creandum, www.creandum.com/investments (2013-01-18)

Swedish Private Equity & Venture Capital Association www.svca.se (2012-12-10)

8. Appendix

Questions from the interview with Per Stenman.

	Agency theory	Stewardship theory
1. Anser ni att det finns risk att entreprenören inte gör det dem borde? (Så att dem riskerar era pengar på ett felaktigt sätt)	✓	
2. Hur gör ni för att försäkra er om att entreprenören är ärlig gällande sin idé? (Adverse selection) ➢ Hur ofta har det hänt att (negativ) dold information kommer upp i efterhand?	✓	
3. Hur övervakar ni att entreprenören följer era incitament? (Moral hazard) ➢ Upplever ni det som ett problem? ➢ Hur ser relationen/kontakten ut med era venture? (Daglig, veckovis eller månadsvis?)	✓	
4. Har ni belöningssystem (om den presterar detta får den…) för entreprenören? ➢ Vad för typ? ➢ Anser dem fungera? Uppskattas av entreprenören?	✓	
5. När ni går in i företaget, ändrar ni vanligtvis alltid organisationsstrukturen på en gång? (Change of organizational structure) ➢ Hur förändrar ni den?	✓	
6. Hur ser ert bidragande ut i det vardagliga arbetet? ➢ Från 0-100 i %, hur självständigt skall entreprenören arbeta?	✓	
7. Använder ni en konkurrensklausul som gör det svårt/dyrt för entreprenören att lämna er?	✓	
8. Hur ser kontrakten ut? Utgår från ett grundkontrakt som förändras beroende på entreprenör?	✓	
9. Tycker ni att det är viktigt att entreprenören får fria händer att kunna arbeta efter eget huvud, om så hur mycket?		✓
10. Brukar ni automatiskt ge mycket autonomi till era entreprenörer från start eller brukar ni vara avvaktande från början?		✓

11. Vad tycker ni är en varningsklocka för att entreprenören går för långt bort från vad är avtalat, och hur skulle ni då få denne att komma på linje igen?		✓
12. Brukar ni ändra ert beteende gentemot entreprenören, utöka/minska på kontrollen?		✓

Övriga frågor:

1. Vill du vara anonym som person och/eller företag?
2. Vill du att vi mailar dig uppsatsen när den är färdig?
3. Får vi kontakta dig om vi har ytterligare frågor?