

Entrepreneurs to venture capitalists: Don't be a Scrooge

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Matt Wood, Ph.D. is an assistant professor of entrepreneurship at Baylor University's Hankamer School of Business. Credit: Baylor Photography

Note to venture capitalists: Entrepreneurs are watching to see if you're naughty or nice.

A recently published study of more than 550 decisions and responses from 144 experienced [entrepreneurs](#) reveals that "knowledge of explicit

ethical or [unethical behavior](#) (by venture capitalists) profoundly shapes the entrepreneurs' willingness to partner."

Baylor University researcher Matthew S. Wood, Ph.D., assistant professor of entrepreneurship in Baylor's Hankamer School of Business, co-authored the study, "Take the money or run? Investors' ethical reputation and entrepreneurs' willingness to partner," which appears in the November issue of *Journal of Business Venturing*.

"Earlier research has focused on how venture capitalists select entrepreneurs, not vice versa," Wood said. "This is an important oversight because there is mounting evidence that entrepreneurs carefully evaluate potential financiers and some, in turn, elect not to accept funding. To date, researchers have not sufficiently investigated why this might be the case and our study introduces 'ethical reputation' as one reason why an entrepreneur might reject a [venture capitalist's](#) offer."

Findings of the study show:

- Entrepreneurs greatly prefer to partner with venture capitalists who are perceived to have behaved ethically in the past.
- "Given the rise of online investor feedback communities, one's ethical reputation is becoming more transparent and, thus, venture capitalists, as well as other investors, should be aware that the sins of the past may influence their ability to partner with high-quality entrepreneurs in the future," Wood said.
- While venture capitalists bring key resources to the table, ethical reputation can trump 'value-added services' and 'investment track record.'

- "Venture capitalists should build and protect their reputation for [ethical behavior](#) via ethical dealings with entrepreneurs and make it known that they adhere strictly to a written code of ethics," Wood said.
- Entrepreneurs will not always run from venture capitalists with a reputation for unethical behavior. Rather, those who are facing serious consequences such as bankruptcy or have a high fear of failure are more apt to overlook poor ethical reputation and strike a partnership.

"This is a major concern for entrepreneurs because it suggests they need to be especially vigilant when they are in a situation where there are severe negative consequences for rejecting funding offers," Wood said.

"In these situations they will be more willing to partner with unethical investors. This is likely trading short-term gain for a long-term loss, and one must carefully consider the future costs of opportunistic behavior on part of the investor that will eventually have to be paid."

More information: www.sciencedirect.com/science/.../S0883902613000761

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