



# The interplay of track record and trustworthiness in venture capital fundraising



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## ABSTRACT

Venture capital (VC) firms raising funds from their limited partners (LPs) have to provide arguments extending beyond the firm's track record to convince those partners to commit to their fund. We suggest that the subdimensions of perceived trustworthiness, that is, perceived ability, integrity, and benevolence, play a vital role in the relationship between VCs and their potential LPs. Our analysis of a worldwide sample of 148 LPs sheds light on LP decision making. In particular, VC firms with medium to high levels of track records seem to benefit from managing trustworthiness. Hence, a VC firm's trustworthiness is not a substitute for a track record but instead something that complements one.

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## 1. Introduction

Without venture capital (VC) entrepreneurial endeavors that set out to change the dominant logic of industries would not be possible (Dimov and Milanov, 2010). However, before VC firms can invest in promising entrepreneurial firms they themselves need to raise funds (Gompers and Lerner, 1998) from what are termed limited partners (LP). Research predominantly ascribes successful fundraising to the organizational track record of the VC firm (Barnes and Menzies, 2005; Kaplan and Schoar, 2005; Balboa and Marti, 2007), but has remained largely silent on other factors explaining the decisions of LPs to commit to a particular VC fund. Thus, explanations beyond track record are desperately needed, and it is this obvious research gap that the present study aims to address.

Following from signaling theory (Spence, 1974), VC funds need to underline their reputation to overcome information asymmetries that arise in their agency relationship with LPs. Track record can prove a powerful tool with which to narrow this information gap between the well informed sender (VC firm) and the comparatively less informed receiver (potential LPs) (Balboa and Marti, 2007), as it can signal the ability to achieve returns above the market average (Harris et al., 2014). However, every situation in which a person or institution takes the initiative to identify themselves or itself as a more attractive contractual partner than the competition is a situation in which "it is conventional to say [the person or institution] is signaling" (Spence, 1974: 475). Hence, simply relying on just one signal, the track record, is likely to oversimplify the reality of VC fundraising.

In trust theory, perceived ability is treated as an essential component of trustworthiness (Mayer et al., 1995) that can trigger trusting behavior (in this case, investing in a VC fund). This perspective suggests that to really understand the success

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of VC fundraising, researchers should consider other ways in which ability is signaled to LPs and at the same time acknowledge the impact of additional theoretical components of trustworthiness other than perceived ability. As trustworthiness is usually seen to comprise both perceived benevolence and perceived integrity of the trustee (Schoorman et al., 2007) as well, a complete picture has to include those additional dimensions. Kautonen et al. (2010: 191) defined the subdimensions of trustworthiness based on Mayer et al. (1995) in the following way:

“Ability is the evaluation by the trustor that the trustee is capable of performing the actions that will be relied upon. Benevolence is an evaluation of the trustee's motivations, such that the trustee has no ill will towards the trustor and that the trustee is genuinely concerned about the trustor's welfare. Integrity is the perception that the trustee is honest and will deal fairly.”

Thus, the perceived ability of a VC firm goes well beyond its (potential) track record, as this is a measure that is primarily oriented toward past achievements (Kollmann et al., 2014) and usually measured as the internal rate of return (IRR) of a particular VC fund (Gompers and Lerner, 1998). In the following paragraphs we will analyze the phenomenon of VC fundraising taking these considerations into account. We will shed some light on the question of how the three dimensions of trustworthiness complement the impact of track record on the decision of an LP to commit to a VC fund. In doing so, we focus our investigation on the interactions of track record and perceived trustworthiness to reveal the supporting (and maybe even thwarting) effects of trustworthiness at different levels of track record. Hence, we aim to paint a holistic picture of successful VC fundraising and lay the foundations for further work in this important research arena.

## 2. Material and methods

### 2.1. Data collection

The Preqin Limited Partner Universe and the Dow Jones LP Source AIP databases were used to identify an initial worldwide population of 888 LPs (Kollmann et al., 2014). 105 LPs had to be removed from the sample due to inactivity. The remaining 783 LPs were invited to participate in a personalized and web-based survey. The survey participants were asked to select themselves to one of two conditions. Either they reported on their last positive or on their last negative investment decision regarding a particular VC fund with which they had completed due diligence. This process resulted in 151 responses of which 148 were usable after adjusting for outliers based on the studentized residual criteria. The final sample size is equivalent to a satisfying 18.9% response rate (Baruch, 1999). The sample is dominated by LPs with headquarters in North America (50%) and Europe (45.27%). The remaining 4.73% are mainly located in Australia and New Zealand. In addition to private equity funds (30.46%), our sample also includes corporate pension funds (12.58%), family offices (12.58%), public pension funds (10.6%) and a category of miscellaneous investors (30.78%) such as endowment plans, insurance companies and investment banks.

**Table 1**  
Descriptive statistics.

	Full sample		Positive decision		Negative decision		t-statistics, t-test of difference in means	Pearson's Chi-square statistics
	Mean	SD	Mean	SD	Mean	SD		
1. Decision (0 = negative/1 = positive)	.60	.49	–/–	–/–	–/–	–/–	–/–	–/–
2. Placement agent (0 = no/1 = yes)	.09	.29	.06	.23	.15	.36	–/–	3.85*
3. After 1st closing (0 = no/1 = yes)	.44	.50	.42	.50	.47	.50	–/–	.50
4. Financial motivation (0 = no/1 = yes)	.76	.43	.81	.40	.69	.46	–/–	2.56
5. Capital under management (in billion €)	16.10	41.73	18.55	42.47	12.39	40.65	.88	–/–
6. Professionals in fundraising	3.76	2.80	4.24	3.21	3.05	1.88	2.83**	–/–
7. Track record	3.67	1.03	4.00	.89	3.18	1.05	4.96***	–/–
8. Perceived trustworthiness	3.65	.69	3.91	.60	3.24	.63	6.55***	–/–
9. Perceived ability	4.08	.80	4.39	.64	3.62	.80	6.44***	–/–
10. Perceived benevolence	3.26	.82	3.46	.82	2.95	.71	3.94***	–/–
11. Perceived integrity	3.69	.80	3.99	.69	3.23	.74	6.35***	–/–
Number of observations	148		89		59		–/–	–/–

\*\*\*  $p \leq .001$ .

\*\*  $p \leq 0.01$ .

\*  $p \leq .05$ .

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