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A Leap of Faith?

A case study of information asymmetries and trust in a deal-by-deal venture capital structure

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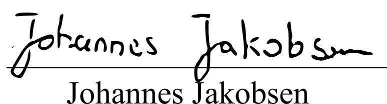
PREFACE

This master thesis is written during the spring semester 2017 as the authors' finishing master degree at NTNU School of Entrepreneurship at the Department of Industrial Economics and Technology at NTNU. The thesis is a theoretical and empirical case study of how trust is connected to how the investors in Viking Venture cope with information asymmetries in a deal-by-deal venture capital structure.

This paper would never have been realized without the support given by our supervisors Lise Aaboen and Roger Sørheim from the Department of Industrial Economics and Technology at NTNU, who have shown us opportunities, enlightened us with new insight and shown high flexibility by giving us rapid and valuable feedback. We want to thank them for their patience. We would also like to thank Viking Venture and the interviewees who took time from their busy schedule to share valuable insights.

Oslo, June 27th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ABSTRACT

Venture capitalists (VCs) are financial intermediaries that invest in growth companies on behalf of their investors, effectively creating an agency relationship where the venture capitalist is the agent and the investor is the principal. Instability has characterized the venture capital industry the past 15 years, and as a result, other structures than the traditional fund structure are emerging. Deal-by-deal structures, structures where the investors commit to investing in one deal at a time, are becoming increasingly popular in venture capital finance. As in any traditional agency relationship, contractual covenants are used by both the investors and the GP to control each other's behavior. However, in a deal-by-deal structure, it becomes apparent that contracts alone are not enough to explain the way the behavior between the parties is regulated, as there are no long-term contracts between the investor and the VC across the investments. Several researchers mention trust as an effective mechanism for regulating behavior, but there is no research on how trust is connected to information asymmetries in deal-by-deal structures. Furthermore, there is an apparent lack of research on both the agency relationship between the LP-GP and deal-by-deal structures in general. Due to this, the purpose of this study is to explore how trust is connected to asymmetric information in a deal-by-deal structure. The purpose is examined through the research question *how is trust connected to how the investors cope with the perceived information asymmetries in a deal-by-deal structure?*

The method chosen for this thesis is qualitative case study. Viking Venture serves as the case company. Viking Venture is a Trondheim-based venture capital firm who successfully transitioned to a deal-by-deal model in 2014. Empirical data has been collected by conducting semi-structured interviews with a sample of Viking's investors. A framework was created based on existing theory to analyze the data collected through the interviews.

The findings indicate that information asymmetries are not reduced by trust, but trust makes the investors more willing to accept the risks related to the asymmetries, providing them with feelings of security. It is also found that trust becomes more relational over time, indicating that the investors' trust in Viking grow as the business relationship develops and the investors learn more about Viking's true abilities. The deal-by-deal structure in itself facilitates trust, as it is more transparent than a limited partnership structure, providing the private investors with much needed flexibility, and allows for more information sharing between Viking and the investors. The findings show that social ties play an important role in building trust and reducing the perceived information asymmetries in the deal-by-deal structure. The authors conclude the thesis by proposing a new analytical framework where social ties are seen as an antecedent of trust.

SAMMENDRAG

Venturekapitalister er finansielle mellommenn som investerer i vekstselskaper på vegne av sine investorer. Dette skaper et agentforhold der venturekapitalisten er agenten, mens investorene er prinsipalene. Venturekapital-industrien har vært preget av ustabilitet de siste femten årene, og som et resultat ser man at andre strukturer enn den tradisjonelle fondsstrukturen vokser frem. Deal-by-deal-strukturer, strukturer der investoren kun komitterer til å investere i ett selskap av gangen, er i fremmarsj i venturekapital-bransjen. Som i ethvert agentforhold er kontrakter brukt av både investorene og venturekapitalistene til å kontrollere hverandres atferd. I en deal-by-deal struktur er det imidlertid tydelig at kontrakter alene ikke er nok til å forklare hvordan atferden mellom partene er regulert ettersom det ikke finnes noen langtidskontrakter mellom investoren og venturekapitalisten som går på tvers av investeringene. Tillit er blant flere forskere nevnt som en effektiv mekanisme for å regulere atferd, men det finnes ingen forskning på hvordan tillit henger sammen med informasjonsasymmetrier i deal-by-deal strukturer. I tillegg er det mangel på forskning på agentforholdet mellom investor og venturekapitalister, og på deal-by-deal strukturer generelt. Derfor er formålet med studien å utforske hvordan tillit henger sammen med asymmetrisk informasjon i en deal-by-deal struktur. Formålet utforskes gjennom forskningsspørsmålet *hvordan henger tillit sammen med hvordan investorene takler de opplevde informasjonsasymmetriene i en deal-by-deal struktur?*

Oppgaven er utformet som et kvalitativt casestudie, der Viking Venture fungerer som casebedrift. Viking Venture er et Trondheimsbasert venture-kapital-firma som har vært gjennom en vellykket overgang fra vanlig fondsstruktur til en deal-by-deal struktur. Empiriske data har blitt samlet inn gjennom semi-strukturerte intervjuer med et utvalg av Viking Ventures investorer. For å analysere dataen har forfatterne utviklet et rammeverk basert på eksisterende teori.

Resultatene av oppgaven indikerer at tillit gjør at investorene er mer villige til å akseptere risikoen som ligger i agentforholdet, mer enn at det faktisk reduserer informasjonsasymmetriene. Videre viser resultatene at tillit blir mer relasjonell over tid, noe som indikerer at investorenes tillit til Viking Venture utvikler seg over tid. Dette blir også påvirket av at investorene etter hvert lærer mer om Viking Ventures reelle evner til å skape verdi. Funnene antyder også at deal-by-deal-strukturen i seg selv fasiliteter tillit ettersom den er mer transparent enn en fondsstruktur. Et annet sentralt funn er at sosiale bånd spiller en viktig rolle i å bygge tillit og å redusere de oppfattede informasjonsasymmetriene i deal-by-deal strukturen. Forfatterne avslutter masteroppgaven ved å foreslå et nytt analytisk rammeverk hvor sosiale bånd blir forstått som forutgående for tillit.

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1. INTRODUCTION

This introductory chapter contains the motivation for the thesis. Further, the purpose and the research question are presented. In the end of the chapter, the contribution and structure of the master thesis are presented.

Entrepreneurs often need investments of growth capital (Lerner & Tåg, 2013) and cash pre-success to be able to develop their product (Gompers & Lerner, 2001). Because outside investors often suffer from information disadvantages and opportunistic strategies, they abstain from investing in new ventures (Eckermann, 2006). The entrepreneurs therefore often turn to venture capitalists. Venture capitalists are financial intermediaries that invest in new ventures on behalf of their investors. In contrast to the investors, venture capital firms have developed a multitude of experiences through previous investments, and have unique capabilities to cope with the problems of information asymmetry in start-up finance and in connecting entrepreneurs with investors (Eckermann, 2006; Lerner & Tåg, 2013).

However, instability have been a hallmark of the venture capital industry the last fifteen years, and since the dot-com bubble burst in 2000, more capital has been invested than returned to the investors in venture capital funds (McCahery & Vermeulen, 2015a). The financial crisis in 2008 further led to a decline in the number of venture capital portfolio companies reaching initial public offerings. The crisis coincided with a few trends that also affected the venture capital industry: new product development methods focusing on reducing startups' burn-rate started to get a lot of traction; crowdfunding models emerged and reduced startups' need to seek investment from institutionalized investors; and business angel investors and super-angels could provide both the capital and the expertise typically reserved for venture capital firms (McCahery & Vermeulen, 2015a). The traditional limited partnership fund structure has also received criticism over the last years, and some researchers even argue that it is "broken" (Mulcahy et al., 2012).

As a result, other structures are emerging. Among these are deal-by-deal structures, which are becoming increasingly popular in venture capital finance, but have yet to receive widespread attention from academic scholars (McCahery & Vermeulen, 2015b). Where the traditional limited partnership structure is receiving more and more criticism, deal-by-deal structures offer more investor-friendly covenants and allows the investor greater control of his or her

own funds by giving them the ability to decide what projects to include in their portfolio on a deal-by-deal basis (Jesch, 2010). Thus, the venture capitalists are providing the investors with more information about the cases receiving investments and some of the decision-making authority is also transferred from their own hands to the hands of the investor. Hence, one can assume that the information asymmetries is reduced in a deal-by-deal structure as opposed to in a fund structure, as more information is available to the investors (Bartlett, 2016).

However, it might not be this simple. Increased access to more information does not necessarily mean decreased information asymmetry. Two important indicators of trusting behavior are reducing control and the rules one place over the other party (Fox, 1974). If the trust is high the investors might not even evaluate the information they are given. Hence, one could argue that if the trust is sufficiently high information asymmetries persists. If information asymmetries persist, the venture capital firm has more chances to act opportunistic (Nooteboom, 1996). A leap of faith can be defined as "an act of believing in or attempting something whose existence or outcome cannot be proved or known" (The Oxford Dictionary, 2017). If the investors do not consider the information they have access to, one could argue that the investors are making a leap of faith, trusting that the other party will act accordingly with the investors' interests. In effect, every time the investors accept the risks that are inherent to the relationship, and acts on this trust, they make a leap of faith.

The situation of an LP considering a venture capital fund, or, on the contrary, a venture capital firm trying to convince an investor to invest, is essentially a situation where a principal is facing an agent (Eisenhardt, 1989), resulting in an agency relationship characterized by asymmetric information (Kollman et al., 2014). Information asymmetries in venture capital finance between the venture capital firm and the entrepreneur have been widely discussed (Sahlman, 1990; Admati & Pfleider, 1994; Lerner, 1994; Gompers, 1995; Jeng & Wells, 2000; Gompers & Lerner, 2001; Sorensen & Stuart, 2001; Kaplan & Strömberg, 2002; Bergemann & Hege, 2003; Dessi, 2005; Hochberg et al., 2007; De Bettignies & Brander, 2007), but the agency relationship between the General Partner (GP = venture capitalists) and the LPs (Limited Partners = investors) has received less attention, both in management, finance, and organizational theory. To the authors' best knowledge, there are no studies about the information asymmetries between the GP and the LP in deal-by-deal structures in venture capital finance. The brunt of the existing research on the LP-GP relationships focuses on moral hazard and adverse selection problems in traditional limited partnership fund structures,

and mainly relies on traditional mechanisms like contractual covenants and monitoring for mitigating problems related to information asymmetry (Gompers & Lerner, 1996). However, in most deal-by-deal structures, the investment pattern is different: the investors invest on a deal-by-deal basis, resulting in a continuous process more than a one-time investment decision as in traditional fund structures. The investors are not contractually obligated to participate in every deal, which means that a big part of the continuous relation between the GP and the LPs are not regulated by contracts.

Since Arrow's (1972) remark that "virtually every commercial transaction has within itself an element of trust", a growing number of researchers have also analyzed the role of trust in economic decisions. Some researchers argue that the economic perspective on reducing agency problems through contracting is undersocialized (Granovetter, 1985; Shane & Cable, 2002; Bottazzi et al., 2016), and one must take into consideration that the possibility of selfish and opportunistic behavior can be mitigated through trust between the principal and the agent (Becerra & Gupta, 1999). As contracts might be the market standard in venture capital finance, perfect contracts are nearly impossible to negotiate, and the investors will as principals search for additional forms of protection (Kollman et al., 2014). Rather than seeing trust and agency theory as opposites, the authors argue that the theories compliments each other (Becerra & Gupta, 1999), and provides a way for understanding trust as a tool for coping with the perceived information asymmetries (Ferris et al., 2017) in a deal-by-deal structure, as trust between the parties can reduce the need for costly monitoring and contracting. This connection between agency theory and trust has, to the authors' best knowledge, not been previously explored in the research field of deal-by-deal structures in venture capital, thus the purpose of this study is to explore how trust is connected to asymmetric information in a deal-by-deal structure.

The authors have conducted a literature review of the theory related to information asymmetries in venture capital finance and trust up to date. The authors have also conducted pilot interviews to be able to develop a framework for analyzing the information asymmetries between Viking Venture and their investors with trust as a complementary perspective, focusing on how trust is connected to how the investors cope with these asymmetries. Viking Venture is a venture capital firm in Norway who recently successfully transitioned from a traditional fund structure to a deal-by-deal structure, where they have attracted smaller private investors and excluded larger institutional investors. The change is apparent - with the

implementation of the new structure Viking Venture have in average raised at least three times more funding from private investors per deal than with their previous traditional fund structure, and have gone from 15 private investors to over 60. Thus, the authors have formulated the following research question:

How is trust connected to how the investors cope with the perceived information asymmetries in a deal-by-deal structure?

With *trust* the authors refer to "a belief, attitude, or expectation concerning the likelihood that the actions or outcomes of another individual, group or organization will be acceptable or will serve the actor's interests" (Sitkin & Roth, 1993, p. 368). By focusing on trust, the authors are looking to explore if and how trust works as a mechanism for accepting the asymmetric information that is intrinsic in the agency relationship. *Perceived* is included in the research question, as the investors must perceive risks in the relationship for trust to emerge. Without risks, trust is not needed (McKnight & Chervany, 1996). Additionally, if the authors were to analyze every information asymmetry that could arise between the parties, the list of information asymmetries would have been long, and the authors would never have been able to capture every single one. Instead, the authors have chosen to focus on information asymmetries one or more of the investors are aware of, including both asymmetries that are regarded as problematic and unproblematic.

The framework has been modified several times, and the framework presented in this thesis is the result of an abductive research approach where the authors have had a continuous interplay between the empirical and the theoretical world. Although the findings can not necessarily be generalized, they are understood in a bigger context to give practical implications to similar structures, and furthermore, identify where further research is needed.

1.1 CONTRIBUTION

This master thesis is a contribution to the literature on the deal-by-deal structure in venture capital, as there is a scarcity of academic papers on the topic. An essential contribution within that context is that important information asymmetries in the new structure are identified. Another important contribution is to examine the incentives that exist in the deal-by-deal structure, and furthermore explore how these incentives affects the investors' perception

Viking's possibilities to act opportunistic. Another contribution is to examine what role trust plays in the deal-by-deal structure. By utilizing McKnight & Chervany's (1996) framework for trust, with certain modifications, the authors will also contribute with a more complex understanding of the trust that exists between Viking and the investors. In summary, this thesis' contributes to the venture capital literature in several ways. First, the thesis is an addition to the literature on the GP-LP relationship in general. Second, the thesis is a contribution to the literature on both agency problems and trust in the venture capital industry. Lastly, and most importantly, the thesis is a substantial contribution to the scarce literature on the deal-by-deal structure in the venture capital industry.

1.2 STRUCTURE OF THE THESIS

The thesis is structured as follows. Chapter one offers an introduction to the subject being studied, introducing the key concepts and the research question of the thesis, revealing that there is a need to explore information asymmetries between LPs and GPs in the light of trust. In chapter 2, the theory regarding venture capital definitions, agency theory and trust are presented, which together forms the theoretical framework of the thesis. Chapter 3 describes the methodological choices that have been made by the researchers to be able to answer the research question of the master thesis. The chapter is concluded with reflections regarding the limitations and trustworthiness of the study. Chapter 4 gives a presentation of the case company and the investors interviewed, while chapter 5 presents the findings related to the data acquisition. In chapter 6, the findings are analyzed in light of the framework presented in chapter 2, thus identifying the information asymmetries in the deal-by-deal structure and how the information asymmetries can be seen in the light of theory on trust. Chapter 7 is a discussion of the research question and the contribution of the key findings. The discussion is revolved around how trust is connected to the of perceived information asymmetries in the deal-by-deal system, and the role of the investment community in developing this trust. At the end of the thesis the conclusion, areas of further research, and implications are presented.

2. FRAME OF REFERENCE

The theories presented in this chapter will form the basis for the literature that will be applied to develop the theoretical framework for the thesis. The first section introduces venture capital and the venture capital structures relevant for the thesis. The second section defines information asymmetries and its main problems, moral hazard and adverse selection, before information asymmetries in a venture capital finance context is presented, with the emphasis on the relationship between the LP and the GP. The third section investigates the literature of trust, including definitions, benefits and risks related to trust and trust in the perspective of information asymmetries. In the end of the chapter the theories presented will be linked together to create the framework, which will be assessed to answer the outlined research question.

2.1 VENTURE CAPITAL DEFINITIONS

In this section, definitions on venture capital and venture capital funds are provided, the limited partnership structure and the criticism of the structure is presented, while the sub chapter concludes with a presentation of the concept of deal-by-deal structures. The information in this chapter will serve as the context for the case study.

2.1.1 Venture capital

Venture capital is a part of the umbrella term Private Equity. Private Equity funds are investment vehicles that make two main types of investments: venture capital and leveraged buyouts (Phalippou, 2007). In this thesis, venture capital is the focus, and leveraged buyouts will not be discussed. Venture capital is by growth equity capital or loan capital that is provided by private investors or specialized financial institutions, and is also often referred to ask risk capital (Gompers & Lerner, 2001; Lerner & Tåg, 2013).

Venture capitalists are the financial intermediaries that invest in new ventures on behalf of their investors. The investments are made through venture capital funds, which the venture capital investors invest in, and the venture capitalists manage. The capital in the fund is invested into a range of companies, which makes up the investment portfolio. A common definition of a venture capital fund is provided by Gompers & Lerner (2001, p. 146) who states that venture capital funds can be defined as "independent, professionally managed,

dedicated pools of capital that focus on equity or equity-linked investments in privately held, high growth companies”. However, this definition does not embrace the new structures arising where the venture capital firms turn away from traditional fund structures and look to i.e. deal-by-deal structures. A definition that seems more appropriate and including of new venture capital structures is Langland's (2007, p. 1144), who argue that venture capital consists of “equity or equity-linked investments in young, rapid growing enterprises that are not quoted on a stock market, and which may have a large growth potential in international markets”. The definition is suitable for this thesis as it is not tied to a fund structure, and it is relevant for both the case company, and the deal-by-deal structure in general.

Venture capitalists are specialists at dealing with moral hazard and asymmetric information (Lerner 1999). To diminish their risk, they use detailed screening processes to generate information about the new venture and the entrepreneur (Lerner & Tåg, 2013), and then make use of financial contracts such as preferred stock and vesting (Kaplan & Strömberg, 2002), staged funding, and demand seats on the board of directors (Hellmann, 1998) to monitor and control their portfolio companies. Venture capitalists enter the portfolio companies as an active investor providing “smart money”, providing not only capital, but also allowing the portfolio company to gain from their networks and competencies (Jeng & Wells, 2010). The expertise, market knowledge, network and knowledge of the entrepreneurial process of the venture capitalists is helpful to help the portfolio companies unfold their growth potential (Gompers, 1995; Bottazzi et al., 2016). Venture capitalists usually invest in young firms in a developing or early commercial phase, which is still dealing with a great deal of risk (Metrick & Yasuda, 2011). To offset the high risk, the venture capitalists expect higher than average return on the investment (Da Rin et al., 2006).

From here on, the investor will be referred to as the limited partner (LP), and the venture capitalists will be referred to as the general partner (GP). The LP delegates the right to manage their assets to the GP.

2.1.2 The limited partnership model

The most common organizational form in the venture capital industry has since the 1980s been the limited partnership, which is thoroughly explained by Sahlman (1990). The limited partnership model has the venture capitalists serving as the GP, and the investors as LPs. The GP make the selection of the portfolio companies and serve as a financial intermediary

between the LPs and the portfolio companies. Its popularity is due to its contractual nature, which allows both the GP and the LPs to reduce opportunism and agency costs (McCahery & Vermeulen, 2015b). On the one hand, the venture capital firms have the time and expertise to conduct the due diligence before choosing what companies to invest in, and they have the time and resources to monitor the companies receiving investments (Gompers & Lerner, 2001). If every investor investing in a company had to spend time conducting an extensive due diligence and monitor the companies receiving funding, it would be very inefficient out of two particular reasons: 1) There would be too much overlap in the monitoring done by the investors, resulting in "too many chefs" for the funded company to focus on doing their job, and 2) some investors would "free ride" the monitoring done by the other investors, resulting in a skewed distribution of time and resources. A third reason for investing through a venture capital fund can be that the investors don not have the time or resources to achieve expertise in early phase or growth phase investments (Lerner, 1999). For these reasons, it has been effective for investors to delegate activities related to investing and monitoring to one party: the venture capital firm. However, as the efficiency of investing might increase, the information asymmetries have not disappeared, and are still very much present between both the GP and LPs, and between the GP and the portfolio companies.

2.1.2.1 The structure of the limited partnership

The limited partnership structure consists of four parties; the venture capital fund, the venture capital firm (GP), the venture capital investors (LPs), and the portfolio companies. In a traditional model, the GP raise money from LPs and place them in a venture capital fund with the promise to yield high returns with smart investments in high growth companies (Sorenson and Stuart 2001; Tarrade 2012; Da Rin et al 2016). The investors can be banks, pension funds, insurance companies, wealthy individuals and so on. Because the GPs often invest in projects that can be characterized as risky, both the GP and the LP expect a higher than average return on the investment (Da Rin et. al. 2006).

The venture capital exerts active management over the portfolio companies (PCs), provide value added services, monitors and mentors the companies, and then exits, as the goal is to convert the investments to hard cash. Most venture capital firms with a limited partnership model are structured as management companies responsible for managing several pools of capital, each representing a legally separate limited partnership.

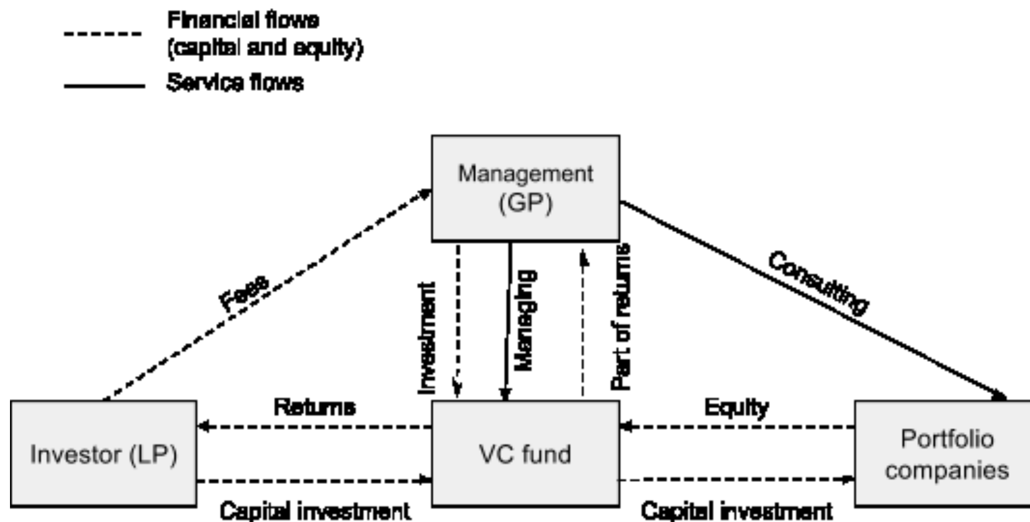

Figure 1: The limited partnership fund structure (inspired by Tarrade, 2012, p. 17)

The GPs typically provide a small proportion (about 1-3%) of the capital raised by a given fund (Phalippou, 2007). The capital from the investors (as the result of a fundraising) is invested in portfolio companies during the first three to five years of the venture capital fund (Tarrade 2012). After that, few, if any, investments are made in companies not already in the portfolio, and the goal is to begin converting the existing investments in the fund to cash by selling the companies from the fund's portfolio. The venture capital fund is usually close-ended, meaning that after a predetermined amount of time, the venture fund will be liquidated and dissolved (Cumming 2010). As the investments yield cash or marketable securities, distributions are made to the partners rather than reinvested in new ventures. Typically, well before all the capital from a venture capital pool is distributed to the partners, a new fund is raised and capital invested in new ventures. Only when an exit has been made, ideally through an IPO or a trade sale, the venture capitalist can be sure to have produced the returns the LPs expect (Tarrade, 2012).

2.1.2.2 Committed capital and fee structure

In a limited partnership fund structure, the capital is committed at the beginning of a fund's life and called by the GP typically within the next five years (Phalippou, 2007). The LPs have committed to investing the capital committed. If the LP is not able to meet his commitment, he will be excluded from the fund and pays a penalty. Further, Ljungkvist & Richardsson (2003) found that 16% of the committed capital is invested at the end of the first year, and that about 80% of the committed capital is invested by the end of year five. Considering this

standard, Phalippou (2007, p. 13) asks if this arrangement might not be optimal, and suggests that

> (...) the GP might have an incentive to raise as much capital as possible and call only what will lead to high performance (to maximize carry). Hence, they have an incentive to obtain more commitments that they can handle.

Phalippou (2007) argue that the fee structure has a large impact on GP performance. In 1999, Gompers and Lerner analyzed 419 venture capital fund fee contracts and found that 81% of the funds had a carry between 20 and 21%. Similarly, Metrick and Yasuda (2006) found that 92% of the funds they studied had a carry of 20%. These findings seem to confirm the typical 2-20 rule in venture capital fee structures. 2-20 refers to the fee-structure where the investor pays 2% of committed capital throughout a fund's life plus a 20% carried interest (including 8% hurdle rate and with full catch-up provision) to the venture capitalists in management fees (Phalippou, 2007). These fees might not seem that expensive at first, but they result in high fees in practice, about 7% a year (ibid). Swendsen (2000) estimated in his study that these fees could be up to 12% a year. As the results mentioned above are deemed to be costly for the LPs, Gompers (1995) suggest reducing fixed fees and increase carried interest to better align the incentives of the GPs and the LPs.

2.1.3 Criticism of the limited partnership structure

Several sources and researchers have discussed problems related to the venture capital structure and limited partnership model (Austin, 2009; Mariathasan, 2015). McCahery & Vermeulen (2014) argue that a constraint has arisen on the capital available for new firms and high-growth companies after the financial crisis in 2008. The reasoning behind the significant decrease in fundraising is said to be triggered mainly by the fact that institutional investors started to shy away from investing in venture capital funds. The reasoning given is that is that the funds are gravely underperforming, that the incentives between LPs and GPs are misaligned and that investors are looking for more investor friendly structures with more investor friendly covenants (McCahery & Vermeulen, 2015b). Mulcahy et al. (2012) concludes in their report from the Kauffman Foundation that the limited partnership investment model is "broken", and condemns venture capital firms for not delivering returns, not adjusting to the times, for being too big, and for a grave misalignment of incentives between the LP and the GPs. The misalignment of incentives is based on the fact that the

structure encourages the GP to raise huge funds at times when funds of such size are not warranted.

> "The most significant misalignment occurs because LPs don't pay VCs to do what they say they will—generate returns that exceed the public market. Instead, VCs typically are paid a 2 percent management fee on committed capital and a 20 percent profit-sharing structure (known as "2 and 20"). This pays VCs more for raising bigger funds, and in many cases allows them to lock in high levels of fee-based personal income even when the general partner fails to return investor capital." (Mulcahy et. al., 2012, p. 4)

Furthermore, they (ibid) argue that LPs accept too high risks when investing in a "black box" GP, and that the LPs rarely require information about GP compensation, carry structure, ownership and the portfolio companies eligible for funding. The solution to the problem is according to the Mulcahy et al (2012) to change the compensation structure, and for LPs to invest in smaller funds where the GPs have committed at least five percent of their own capital to the investments, and where the investments are directly in startups or growth phase companies. They also recommend LPs to conduct more rigorous performance analysis on the GPs, and to negotiate, evaluate and structure investments in venture capital firms that are more transparent and aligned.

2.1.4 Deal-by-deal structures

Deal-by-deal structures and pledge funds have been gaining popularity in the venture capital industry (McCahery & Vermeulen, 2015a). Deal-by-deal serves as an umbrella term for many types of structures in various industries such as shipping and real estate. The main takeaway in a deal-by-deal structure is that the LPs do not commit to investing before the investments are identified, and that they are offered the right to "opt out" of each investment opportunity, giving the LPs the ability to select which individual part of the project they wish to support with their capital (Kittredge & Rife, 2014). The specifics of the different deal-by-deal structures varies, but in general they are often inspired by the investment structures in shipping and real estate. However, instead of investing in an "empty" fund, often called separate accounts where, the LPs make several single investments in predetermined companies, presented to them by the venture capital firm. In this thesis, we will focus on the general characteristics of a deal-by-deal structure in venture capital, and will in this chapter

use deal-by-deal as an umbrella term for all structures in venture capital finance operating on a deal-by-deal basis.

In a deal-by-deal structure, the GP assembles a group of qualified investors who are interested in investing in the sector and stage defined by the manager. The GP negotiates a deal, and offers the deal to the investor group that is free to take it or leave it on an individual basis (Bartlett, 2016). This sort of structure gives the investors the opportunity to invest on a deal-by-deal basis, giving the LPs more discretion on whether or not to accept the GPs investment proposal or not (ibid). The LPs are not obligated to participate in the deals presented to them, but are expected to participate in the consequent investments suggested by the GP. That way, the LP effectively builds his or hers portfolio bottom-up, not top-down as in the traditional fund structure, thus having the ability to diversify and spread the risk as they wish (McCahery & Vermeulen, 2014). Kelleher (2013) argues that deal-by-deal structures are beneficial for the LPs out of at least two reasons: first, the structures are flexible for the LP in the sense that they are usually tailored to their appetite for risk and need for diversification. Second, it is "obvious" that the direct and close relationship between a single LP and a GP enables the LP to bargain for better terms and conditions, including investor-favorable and "disruptive" management fees and carried interest provisions. According to Myles (2013), especially small and medium investors, such as family offices and wealthy individuals are attracted to deal-by-deal arrangements.

The fee structure varies, but the GP is usually paid through a combination of management fees on invested (not committed) capital, a carry calculated on a deal-by-deal basis and one-time investment fees. There is no committed capital under management of the GP, only indication of interest from the LPs (Bartlett, 2016). Thus, the pledge fund offers the LP greater control over portfolio acquisitions and the possibility to avoid high management fees. However, according to Jesch (2010), pledge funds usually come with higher transaction costs, and may suffer from lower returns on investment. He blames this on a lack of diversification, and what he refers to as a "cherry picking problem" from the GPs side.

According to Kittredge & Rife (2014), deal-by-deal structures can be useful for a GP seeking to build a relationship with a prospective investor or for a GP seeking to deepen its track record (Kittredge & Rife, 2014). However, some argue that they are generally used as a "stepping stone" towards establishing a more traditional venture capital fund rather than as a

long-term strategy, as it generally is a less fruitful strategy for the GP. According to Mariathasan (2015) deal-by-deal structures can be viewed as somewhat of a last resort for firms that are struggling with raising a traditional fund and that they have no other choice but to try to stay in business through structures such as pledge fund structures, as the structure allows for the GP to receive the minimum commitments necessary to stay in business.

2.2 AGENCY THEORY

Since the important contribution of Jensen & Meckling (1976) agency theory has emerged as one of the most important theories in management, finance and accounting (Becerra & Gupta, 1999). Jensen & Meckling's contribution can be categorized within the positivist agency theory, as opposed to the more mathematical principal-agent theory. Agency theory is based on a dyadic relationship between an agent and a principal, where the principal delegates certain tasks to the agent who then performs the task (Eisenhardt, 1989; Becerra & Gupta, 1999). Other important contributions to the positivist agency theory is Fama & Jensen (1983), who discussed how equity ownership by managers aligns manager's interests with those of the owners, and Eisenhardt (1989) who assesses agency theory and its contributions to organization theory. In the positivist stream, the common approach is to identify policies or behaviors in which the agent and the principal have diverging interests, and then demonstrate that information systems or outcome-based incentives can solve the problems. Where the positivist stream lays the foundation, and explains why agency relationships exist and what contract alternatives are available, the principal-agent stream focus on finding the most efficient way to contract alternatives in a given situation (Eisenhardt, 1989). In this paper, we will take a positivist view on agency theory and information asymmetries.

According to Morris (1987) an agency relationship arises in situations where there is a separation of ownership and control in a firm, of suppliers and capital, and of risk bearing, decision-making and control functions in firms. Jensen and Meckling (1976, p. 309) define an agency relationship as "a contract under which one or more persons (the principal(s)) engage another person (the agent) to perform some service on their behalf which involves delegating some decision-making authority to the agent". Thus, the objective of agency theory is to design a contract that minimizes the costs related to information asymmetry in a principal-agent relationship (Becerra & Gupta, 1999). These costs are further related to the possible conflicts in the agent-principal relationship (Morris, 1987) and the principal must try to

provide the agent with the correct incentives to maximize the value of the principal's investment opportunity (Mæland, 2011). It is close to impossible for the principal to ensure that the agent will make optimal decisions from the principal's viewpoint. However, the principal can try to limit undesirable behavior by establishing appropriate incentives for the agent, and by monitoring the agent (Eisenhardt, 1989). As stated by Fama & Jensen (1983), this separation of ownership and control might produce conflicts, and thus the objective of agency theory is to reduce these costs.

The main problem in agency theory is known as information asymmetry: the situation where one party has more information than the other party (Mishra et al., 1998; Eisenhardt, 1989). Information asymmetry is the opposite of information symmetry, where both parties are equally informed. Asymmetric information can arise accidentally or it can be intended. Information asymmetries can occur unintentionally if one party does not have the expertise, time or resources to access information. If a market participant refuses to reveal relevant information to secure their own benefits or to refuse to reveal information to lower the other party's disadvantages (Eckermann, 2006), the asymmetric information can be said to be intentional from the agent's side. The principal does not have complete information regarding either the amount of effort invested by, or the underlying competence of, the agent in respect to the tasks the agent is to complete (Eisenhardt, 1989). Figure 2 provides an overview over the different types of information asymmetries (Eckermann 2006, p. 7) Intended information asymmetries can be divided into three problems: problems with hidden characteristics, hidden information and hidden intentions.

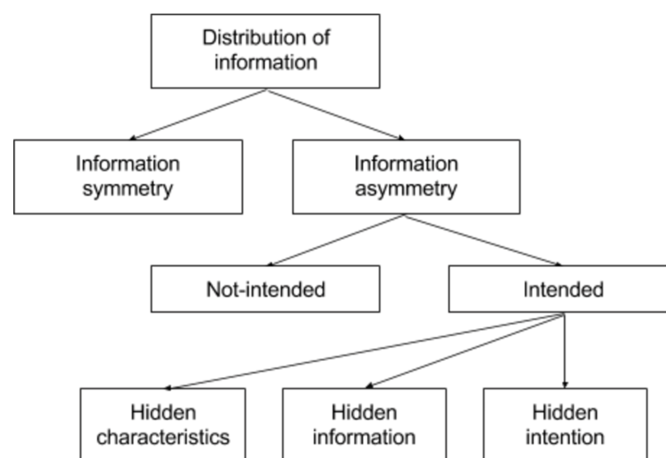

Figure 2: Information asymmetries (Eckermann, 2006, p. 7)

Hidden characteristics refer to the situation where a party can hide its negative characteristics against other parties to avoid the other party to modify the contract in a way that would cause them distress. Thus, hiding potentially negative characteristics can prove less costly to the first party than to reveal them. Hidden information refers to the situation where one party is neglecting to share particular information about an investment opportunity which may negatively influence an upcoming transaction and simultaneously. The hidden information allows the first party from extracting personal benefits from the deal. Hidden intentions refer to a situation where one party might hide its true intentions to other parties before, during and after contract is entered to be able to extract personal benefits.

These problems are in most other literature categorized as respectively moral hazard and adverse selection, where moral hazard refers to the situation where it is difficult or expensive for the principal to verify that the agent is behaving appropriately, and adverse selection refers to a situation where the underlying competencies of the agent is hard or impossible for the principal to uncover before the task is delegated (Eisenhardt, 1989).

2.2.1 Moral hazard

Moral hazard is concerned with lack of effort on the part of the agent, which refers to a situation where the agent does not exert the expected effort in completing the task (Pratt & Zeckhauser, 1985). Moral hazard is further described as a situation where the agent shows lack of efforts in pursuing contractually fixed goals, and the agent does not carry the full consequences of his or her actions (Eckermann, 2006). Hence, moral hazard describes a situation where the agent explores the incompleteness of the contract and hides negative information or engages in self-beneficial behavior without being liable for his or her breach of contract (ibid). A contract between an agent and a principal can never be complete (Sitkin & Roth, 1993) out of at least two reasons (Eckermann, 2006):

1. The principal cannot completely supervise all the agent's actions. Rather, he audits the project periodically. Thus, the principal cannot with full security isolate the agent's actions from the project's outcome.
2. The contract between the principal and the agent cannot foresee every future scenario, as humans only have bounded rationality. Thus, the principal cannot design contracts that completely stipulate the agent's actions, he cannot observe if the agent complies

to the contracts, therefore he cannot contractually assign the full consequences of the agent's actions to the agent.

Researchers have mostly focused on two general mechanisms by which principals can cope with moral hazard problems. First, the principal can monitor the agent's behavior by employing reporting systems, budgeting or board representation (Eckmann, 2006). Second, moral hazard problems can be resolved or mitigated using incentives that reduce the gains of quality cheating. These incentives often come in the shape of an economic, written contract between the principal and the agent. The contract regulates the context of the relationship, and provides incentives that align the interests of the agent with those of the principal, thus reducing the attitudinal differences (Becerra & Gupta, 1999). More specifically, Kreps (1990, p. 577) notes that moral hazard problems can be solved by "structuring a transaction so that the party who undertakes the actions will, in his own best interests, take actions that the second party would prefer".

2.2.2 Adverse selection

Where moral hazard describes a situation of hidden actions in a transaction, adverse selection describes a situation where the type of product is hidden from one party in a transaction (Eckermann, 2006). According to Hughes (1985, p. 119) "Unobservability of product quality can lead to the existence of asymmetric information about quality between buyers and sellers in the product market". Thus, adverse selection is the situation where an undesired result occurs because one party has more accurate or different information than the other party. This can also be referred to as the principal's inability to ascertain the agent's skills before, during and after the transaction (Akerlof, 1970). The agent may not have the competence or skills he or she claims to have, and it is difficult for the principal to completely verify these competencies or skills either at the time of hiring or while the agent is working (Eisenhardt, 1989). Another example of an adverse selection is a customer whose skills are not adequate to verify the quality of the product provided by seller. Because of the lack of skills and information, the customer is at risk of being opportunistically exploited by the seller (Mishra et al., 1998).

Much of the literature on adverse selection is adapted from the seminal work of Akerlof (1970) and his explanation of "the lemon problem". In his study, he examines how the quality of a product or service traded in a market can reduce the presence of information

asymmetries, leaving only “lemons” behind. A “lemon” is a term for a car that is found to be defective after it has been bought, and the “lemon problem” refers to the situation where the seller knows if his product is a lemon, but the buyer has no way of distinguishing between the “lemons” and the “peaches” (high quality products). As the buyer is uninformed, he assumes that all cars are the average of a “peach” and a “lemon” and is only willing to pay the price of the average value of a peach and a lemon. A seller holding a peach will not sell his car at such a low price, and will have an incentive to leave the market, meaning there will only be lemons left, and the buyers willingness to pay will decrease, resulting in even more sellers leaving the market, creating an adverse selection problem.

2.2.2.1 Signaling

In general, problems with adverse selection can be resolved by signals (Akerlof, 1970). Signaling is referred to as “the publication of a device which acts as a prediction of superior quality” (Morris, 1987:48), and signaling theory is focused on the credible communication of information to present positive organizational attributes in situations influenced by information asymmetries (Alsos & Ljunggren, 2013). Quality in Morris’ (1987) definition refers to the unobservable ability of the signaler to fulfill the needs or demands of an outsider observing the signal (Connelly et al., 2011). The signals aim at revealing the parties’ private information about their skills or characteristics (Mishra et al., 1998) by signaling it to others (Morris, 1987), thus reducing adverse selection problems. To be effective, poor quality sellers must not easily copy the signal. To ensure this, the assumption usually made is that signaling costs are inversely related to quality. The concept of quality shares some characteristics the term “reputation” (Kreps & Wilson, 1982), and researchers have described how firms attempt to gain a positive reputation as a signal of underlying quality (Deephouse, 2000; Coff, 2002). As Schmidt and Wahrenburg (2003) point out, reputation can be viewed as a security given by the agent to the principal. According to Connelly et al. (2011), the effectiveness of the signal depends on their observability and how expensive they are for the signaler. Investors have been found not to value weak signals, and will consider costly signals as more credible (Lee, 2011). The signal must also be confirmable with actual product quality observed after purchase (Morris, 1987). However, the receiver’s attention, interpretation and perception also decide the extent to which the signals are valued as intended by the signaler (Connelly et al., 2011).

2.2.3 An undersocialized theory?

Multiple researchers have criticized agency theory for being undersocialized (Granovetter, 1985; Perrow, 1986; Becerra & Gupta, 1999; Shane & Cable, 2002). Perrow (1986) argues that the focus of the theory is to optimize monitoring and incentives, and that the application of such “stick and carrot” theory can contribute to increasing the attitudinal differences between the agent and the principal in the long run. Shane & Cable (2002) claims that these types of economic explanations do not consider how social ties affects the process. The authors (Ibid) receive support from other authors when they argue that these explanations are undersocialized and incomplete, and that the transfer of information through social capital and social ties plays a part in overcoming the problem of information asymmetry by replacing written contracts (Venkataraman, 1997; Shane & Cable, 2002; Ferris et al., 2017).

2.2.3.1 Social ties

Shane & Cable (2002) is concerned with social ties in networks and how these social ties can alleviate information asymmetries. They distinguish between direct social ties and indirect social ties in information transfer; direct ties are defined as “a personal relationship between a decision maker and the party about whom the decision is being made” (Larson, 1992). Indirect ties are defined as “a relationship between two individuals who are not directly connected but through whom a connection can be made through a social network of each party’s direct ties” (Burt, 1987). Thus, direct ties refer to an ongoing relationship and indirect ties refer to other people in the network, mainly friends of friends. Under the conditions of information asymmetry and uncertainty, direct ties can provide an advantage to those searching to collect resources from others, as one has easier access to private information (ibid). Prior contact between the agent and the principal may reduce and even eliminate their attitudinal differences and as a tool for aligning their goals (Granovetter, 1985), and mutual knowledge and identification between the two parties can generate trust (Becerra & Gupta, 1999), thus creating information flows, which can increase one’s ability to obtain information that is not public (Nohria, 1992). In a relationship with direct ties one also has a social obligation, which may cause the parties to behave generously towards each other (Gulati, 1995; Shane & Cable, 2002).

Indirect ties can transfer expectations about people’s behavior from one relationship to another, and social debt is accumulated between the parties. As a result, indirect ties can serve as a screening mechanism, improving the quality of applicants by helping to screen out

unqualified individuals (Shane & Cable, 2002). The logic of access to private information can be transferred to venture capital finance, in which investors use their social relationships to locate investments, as well as the logic of social obligation can provide a more socialized view of investor's decision making, such as suggesting that the investors investments partly depends on the relationships between the investor and the company receiving funding rather than pure competence-based criteria (Shane & Cable, 2002).

2.2.4 Information asymmetries in limited partnership structures

Several researchers on venture capital finance concludes that information asymmetries is the main reason for the existence of venture capital as an early stage financing instrument, and that venture capital exist because information asymmetries and the inherent uncertainty related to the performance and growth of the companies prevents common equity investors from direct engagements (see Davila et al., 2003, Gompers, 1995, Gompers & Lerner, 2001, Hsu, 2004, Eckermann, 2006). When the LP delegates decision-making power to the GP in investing funds, it is understood that the agent (GP) will act in the best interest of the principal (LP). Given the nature of this relationship, there is certain information that is only available to the GP, thus leading to asymmetric information that may result in two problems: adverse selection and moral hazard (Balboa & Marti, 2007). The delegation of this task conveys the idea of separation between ownership and control (Cherif & Sraieb, 2008).

As the GP serves as an intermediary between the investor and the portfolio companies, the LP must cope with two levels of information asymmetries: the GP has more information about both their own performance, abilities and goals, as well as more information about the portfolio companies than the LP. Furthermore, the LPs are prevented from intervening in the GPs choice of portfolio companies, hence the GP can choose to invest in bad projects, but the LP cannot distinguish the good projects from the bad ones (Kandel et al., 2011). The portfolio company has more information about their own venture, performance and quality than the GP. Consequently, once the investors have invested their capital in a venture capital fund, and the venture capitalists has invested the fund in portfolio companies, both the venture capitalists and the portfolio company have incentives to make decisions that expropriate the investor's capital (ibid).

2.2.4.1 Regulating the GP's behavior through contracts

The principal and the agent sign a contract which specifies the rights of the agent, the criteria for evaluating the results of his action and management, and the reward for his or her performance (Fama & Jensen, 1983), thus aligning the incentives of the GP with those of the LPs (McCahery & Vermeulen, 2015b). There are several ways of aligning these incentives including a) the mutual gains of incentives, b) the limited life span of the fund, c) monitoring of activities of the GP (Fried & Hisrich, 1994), and d) to keep the LP regularly informed (Sahlman, 1990). Furthermore, the contracts usually include various covenants, including limits on the amount that can be invested in any one company, restrictions on co-investments with other funds raised by the same firm, rules about reinvestment of profits, limits of the ability of GPs to invest personal money directly in portfolio companies, restrictions on future fund-raising abilities and restrictions on GPs outside activities (Gompers & Lerner, 1996; Phalippou, 2007). However, the cost of drawing up detailed contracts is very high, and there are usually loopholes in the contracts, providing the GPs a possibility to act in their own interests (Kollmann et al., 2014).

One mechanism the LPs can use to control the behavior of the GP through contracts is the limited life span of a fund (Kandel et al., 2011). Only when an exit has been made, the GP can be sure to have produced the returns the LPs expect (Tarrade, 2012). There seem to be no consensus of the optimal lifetime of a fund, and researchers reports a lifetime of everything between 3-13 years (Gompers & Lerner 1995; Bascha & Walz 2001; Langeland 2007). However, venture capital firms that invest in ventures or industries that takes a long time to produce results are more prone to information asymmetries than investments with a shorter timespan (Lerner & Schoar, 2004). Félix et al. (2014) notes that because the degree of information asymmetry between the GP and the portfolio company is expected to decrease over time, one should expect that both the GPs and the LPs should keep their investments for a longer duration of time when the degree of information asymmetry is high. On the other hand, Gompers & Lerner (2001) argue that a time-restricted structure forces the venture capitalists to take the painful, but necessary, steps of terminating the underperforming firms in their portfolios. Kandel et al. (2011) argue that, if the buyers are unable to distinguish between the projects, the GPs will prefer to continue bad projects and sell unfinished good projects, and that the lifetime of a fund should be decided based on the level of transparency in the agency relationship. This is in line with Hsu & Kenney (2005) who propose that the

limited life of the partnership forces the GP to raise new funds, demonstrating their abilities, which is regarded as the main source of uncertainty in the relationship.

2.2.4.2 Reputation

The GP must reduce the adverse selection problem by signaling their quality through their reputation, as a good reputation can signal that the specific GP is of higher quality than other GPs. (Kandel et al., 2011). Theoretically, the importance of a reputation can be deduced from the fact that the GP is the better-informed party and might withhold crucial information that may lead to adverse selection (Amit et al., 1998): the LPs do not know the real quality of the GP before they learn about it by investing in the fund (Lerner & Schoar, 2004), making a performance-based reputation critical (Hsu & Kenney, 2005).

2.2.4.3 Transferring stakes

The stakes of the LP in a traditional fund is generally not readily transferrable. The investments are often highly illiquid and difficult to sell for an attractive price outside of an exit. The reason for this can be related to the GP's desire not to publish information about the funds they manage (Phalippou, 2007). The LPs might have the possibility to sell their stakes to other investors already invested in the fund or others, but according to Phalippou (2007), GPs wish to avoid stakes ending up in the hands of investors who does not have a long-term commitment to the fund or the asset class. This may be related to the fact that the GPs wish to secure investors that will "stick around" during the next round of fundraising and avoid having to pay a "lemon" premium by asking outside investors (Lerner & Schoar, 2004). The lemon premium is by Lerner & Schoar (2004) referred to as "the illiquidity puzzle", a situation where one assumes an information asymmetry about the quality of the manager between the existing LPs and the market.

Given that the information about the GPs performance is not made public, the best way to attain information about the quality of a fund is by being on the inside (Lerner & Schoar, 2004). If the LP is not satisfied with the fund's performance, LPs will typically choose not to invest in the subsequent funds raised by the GP. Hence, the GP should derive at least some part of their motivation to perform well by the threat of termination of investments (Klein & Murphy, 1988). The LP's effort to try to monitor the fund is based on the desire to get better information that can influence the decision to reinvest or not. Following this logic, the GP

faces an adverse selection problem in the outside market, as the GP will be forced to attract outside investors if the existing investors experience a liquidity shock. These outside investors will wonder why the inside investors passed on investing in the new fund, as there is no sure way for them of knowing if the fund is a lemon or if the other investors really experienced a liquidity shock.

2.3 TRUST

The overarching goal of the thesis is to examine how trust is connected to how the investors cope with the perceived information asymmetries in a deal-by-deal structure. The previous subchapters have laid the basis for the theory on venture capital and agency theory. In this chapter, the theory related to trust in the framework will be presented. As Arrow noted (1972, p. 357), "virtually every commercial transaction has within itself an element of trust". In line with this, Granovetter (1985) argued that trust could be said to be an essential ingredient in the social context of economic transactions. Williamson's (1985) research shows that if personal trust is present, asymmetric exchange relationships will display greater adaptability and will survive greater stress. When it comes to general financial decisions, Guiso et al. (2008) found a significant positive relationship between trust and the willingness to invest. Trust is therefore a very relevant theory when studying information asymmetries in the context of venture capital.

2.3.1 Conceptualization of trust in the literature

According to Sitkin & Roth (1993, p. 368) most papers on trust accept, explicit or implicit, the definition of trust as

> A belief, attitude, or expectation concerning the likelihood that the actions or outcomes of another individual, group or organization will be acceptable (Garfinkel, 1963; Jennings, 1971; Luhmann, 1979; Barber 1983; Lewis and Weigert, 1985) or will serve the actor's interests (Deutsch, 1962; Kee & Knox, 1970; Larzelere & Huston, 1980).

However, some researchers study trust as an interpersonal concept (Scanzoni 1979; Granovetter, 1985; Williamson, 1985; Rousseau et al., 1998) while others are interested in trust as a systematic phenomenon (Luhmann, 1982; Putnam, 1993; Fukuyama, 1995). Furthermore, the conceptualization of trust is often shaped by the research field the researcher

belongs to (Misztal, 1996), which means that certain aspects of trust are more emphasized than others. This have led to what Shapiro (1987, p. 624) calls “a confusing potpourri of definitions applied to a host of units and levels of analysis”. As a result, different academics conceptualize and operationalize trust in ways that is not always compatible across disciplines. McKnight & Chervany (1996) and Misztal (1996) are among the academics who have recognized this problem and tried to create a coherent understanding of trust.

2.3.2 Trust conceptualized

In their paper from 1996, “The Meaning of Trust”, McKnight & Chervany present an overview of the different strands of the theoretical understandings of trust. They (ibid) further propose a new framework for analyzing trust. Instead of a narrow conceptualization, that is so often used, McKnight & Chervany (1996) provide six trust constructs. These constructs are based on 28 articles written by other trust theorists, among them academics such as Rosenberg (1957), Garfinkel (1967), Rotter (1967), Erikson (1968), Johnson-George & Swap, (1982), Shapiro (1987), Lewis & Weigert (1985), and Wrightsman (1991). The six constructs are trusting intention, trusting behavior, trusting beliefs, system trust, dispositional trust, and situational trust. There is an intrinsic relationship between the constructs as the trusting beliefs lead to trusting intention, which in turn is manifested through trusting behavior (McKnight & Chervany, 1996).

2.3.2.1 Trusting Intention

Trusting intention is defined as the “extent to which one party is willing to depend on the other party in a given situation with a feeling of relative security, even though negative consequences are possible” (McKnight & Chervany, 1996, p. 27). Trusting intention entails one person being ready to depend on another party in a specific situation. Furthermore, this is an intentional state, defined at an individual level of analysis, and it is personal and directional. The construct consists of five central elements synthesized from the literature: 1) Potential negative consequences, 2) dependence, 3) feelings of security, 4) situation-specific context, and 5) lack of reliance on control.

Potential negative consequences entail the potential risks involved when trusting, because without risks the situation would not require the formation of trusting intention. The amount of risk needed is not specified. This is in line with Rousseau et al.’s (1998) understanding of

trust, which is that without risk there is no need to develop trust in the relationship. Dependence means one's interest (what is at stake) in satisfactions provided by the other person (McKnight & Chervany 1996, p. 28). Dependence is an important part of trusting intention and involves the concept of dependence on another person: the "one who becomes dependent upon other places the other in position of power over her/him" (ibid, p. 28). Dependence is a prerequisite for trust because one does not need to be willing to depend on the other if it is not required. Several researchers define trust *as* dependence (Scanzoni 1979, Lewis & Weigert 1985, Atwater 1988). Dependence is linked to the concept of power because the one who becomes dependent on another person gives the other person the power over the one who is dependent. This is, arguably, the antithesis to control-based power which means one party attempts to influence the other party to ensure the desired outcome (McKnight & Chervany, 1996).

Trust has in some cases been defined as either lack of fear (Bradach & Eccles, 1989), comfort (Eayrs 1993), or feelings of security (Lewis & Weigert 1985). Feelings of security refer to a situation where one feels assured, safe and comfortable about depending in others (McKnight & Chervany 1995, p. 29). Rempel et al. (1985) argue that felt security is what enables the trustor to make the "leap of faith" beyond the evidence they possess about the other party. Whereas the other are aspects of trusting intention are cognitive, feelings of security are emotional.

Trusting intention is situation-specific in that one does not trust the other party to do every task on one's behalf. Instead, over time one develops certain expectations to certain people for certain tasks (Baldwin, 1992). (...) In practice this means that you would trust your lawyer to handle legal situations, but you would not trust him to handle your health. Trusting intention is different for willingness to depend because dependence can involve control mechanisms that reduces the need for trust to zero. The distinction between control and power and trusting intentions is that the person who is exhibiting trusting behavior must rely on trust, and not on control mechanisms. (McKnight & Chervany, 1996, p. 30). By this definition one could view control as a substitute for trusting intention (Rousseau et al., 1998).

2.3.2.2. Trusting Beliefs

Trusting beliefs is based upon one person's cognitive beliefs about the other party. Trusting beliefs is by McLain & Hackman (1995) explained as the extent to which one feels confident

in believing that the other party is trustworthy in a given situation. Trustworthiness is described as the willingness to act in the other party's interests (McKnight & Chervany, 1996). This concept is based on the person's belief about the other person and includes the person's degree of confidence in those beliefs. These trusting beliefs consists of four concepts: 1) *Benevolence:* that one is motivated to act in the other person's interest because one genuinely cares about the welfare of the other person. A benevolent person will not act opportunistically toward the other person. 2) *Honesty:* that one tells the truth, fulfills any promises made, and make good on faith agreements (Bromiley & Cummings, 1995), 3) *Competence:* the ability to do the things that the other person needs to have done (Stein, 1971), 4) *Predictability:* the consistency in one's pattern of behavior, enabling the trusting party to predict what one will do in a given situation (McKnight & Chervany, 1996).

There is an important relationship between these four beliefs that constitute trustworthiness:

> Benevolence is the essence of willingness to serve another's interests. Competence is the essence of ability to serve another's interests. One with honesty will prove one's willingness by making and fulfilling agreements to do so. Predictability embodies an element of temporal continuity that can be related to the other trusting beliefs (McKnight & Chervany 1996, p. 34).

Hence, they are related in that they embody different aspects of trustworthiness. Furthermore, there is a time-element in trusting beliefs. For example, is it difficult for the trustor to get a clear perception of the predictability of the trustee if they have not interacted before.

The source of the information the trusting party base their beliefs on is often in relation to the person's own dealings with the other party. Being able to competently evaluate the trustworthiness of the other should therefore increase as the interactions continue (Axelrod 1994; Rousseau 1998). However, one often must decide to trust without having interacted with the other person or organization before. Researching social capital, both Coleman et al. (1966) and Granovetter (1973) show that social relationships within communities facilitates information flow and knowledge flow between the individuals in that community. Furthermore, Shane & Cable (2002) show how social ties in a network can alleviate the information asymmetry that exists between two parties, which also includes information about trustworthiness.

2.3.2.3. System trust

System trust "means to which extent to which one believes that proper impersonal structures are in place to enable one to anticipate a successful future endeavor" (McKnight & Chervany, 1996, p. 36). System trust is impersonal, and one can differentiate between two types of impersonal structures: structural assurance and situational normality. The former includes safeguards such as contracts, guarantees, and regulations (Zucker, 1986; Shapiro, 1987). The latter includes others and one's own role in the situation (Baier, 1986). This is based on the perception that things seem to be in proper order (Garfinkel, 1967) or appear normal (Lewis & Weigert, 1985). System trust supports trusting intention because the structural assurance safeguards and the situational normality enables one to feel more secure in taking risks with other people (McKnight & Chervany, 1996, p. 37). As the trusted structure is impersonal, the important part is the trusting person's beliefs about the structure.

2.3.2.4. Dispositional trust and situational disposition to trust

The construct of dispositional trust is based on the literature on generalized trust and entails that people over time develop generalized expectations about people's trustworthiness (Rotter, 1967; Erikson, 1968). This makes dispositional trust a cross-situational and cross-personal construct. The degree of dispositional trust a person has is to what degree he or she have the tendency to trust different persons and in different situations. Riker's (1971) understanding of the concept of situational disposition to trust is to what degree on party intends to depend on a non-specific other party in a specific situation. In practice, this means that every time a particular situation arises, the trustor has formed an intention to trust, independent from the trustor's beliefs about the personal characteristics of the other party in the situation. This construct is intentional in that it relates only to specific situations, not across all situations. An example of this could be that the passengers on a plane trust the pilot to safely transport them to their destination (McKnight & Chervany, 1996).

2.3.2.5 Trusting behavior

Trusting behavior is a result of trusting intention because willingness to depend leads one to depend on the other party. While trusting intention is (mostly) cognitive, trusting behavior is a behavior-based construct. This construct is behavioral in that one acts on the trust that exists. Trusting behavior is present in situations where one person voluntarily depends on another party in a specific situation even though negative consequences are possible (Lewis &

Weigert, 1985; McKnight & Chervany, 1996). This definition includes that the trusting person accepts the risks involved. A prerequisite for trusting behavior is therefore that there is little to no use of control.

2.3.3 Benefits and risks related to trusting relationships

Trust comes with both benefits and risks. Trust is built over time and develops between actors involved in an exchange relationship. When one trusting act is reciprocated by another a durable basis for co-operation can emerge (Axelrod, 1984). Over time certain expectations to behavior forms within a relationship (Lane & Backmann, 1998). In this context, it is important to understand how trust is built, and how one can take strategic action to build trusting relationships. Das & Teng (1998) argue that proactive information and proactive information exchange is an important ingredient in trusting relations. In line with this reasoning, Leifer & Mills (1996) note that communication is effective in building trust because it provides the basis for continued interaction. To build trust, one must also show a willingness to communicate over a range of issues (Webb, 1991). Making adaptations according to the trustor's needs and being willing to invest in the time dimension is understood as trusting behavior (Murakami & Rohlen, 1992; Das & Teng, 1998). Finally, managing expectations is an effective way to build trust. This means not giving clear goals with high expectations but rather give ambiguous goals with low expectations (Butler & Gill, 1996). Among the benefits mentioned in the literature is the effect trust have on reducing transaction costs and conflict. On the other hand, trust can be vulnerable and can lead to the underestimation of opportunistic behavior from the trustor's side.

2.3.3.1 Reducing transaction costs

The effect trust has on reducing transaction costs can be seen in relation to the effect trust have on negotiation costs. Organization economics are interested in the costs associated with conducting exchange. These costs are a result of the exchange partners' inability to fully specify the contingencies in a contract. Zaheer et al. (1998) argues that the parties' ability to limit the costs associated with contracting affects the performance and efficiency of an exchange relationship. The logic here is simple, the lesser the trust, greater will the transaction costs be. Trust is a mechanism that, to a large extent, will reduce the need to guard against opportunistic behavior. In practice this reduces the need to develop large contracts that elaborate safeguards for monitoring, specifying, and enforcing agreements. Furthermore, one

could argue that if the exchange is highly monitored there is no reason to develop trust at all (ibid).

2.3.3.2 Reducing conflict

Relationships with high levels of trust are more likely to have a lower level of conflict. There are two conflicting views on why this is the case (Zaheer et al., 1998). The first perspective argues that because the parties will be less focused on the personalities of the parties and rather on developing solutions that are focused on the problem. Furthermore, trust will more likely make the persons involved give the other the benefit of the doubt instead of jumping to conclusions (Macneil, 1980; Fisher & Ury, 1991; Currall & Judge, 1995). The contrasting view is that trust allows conflict to surface but without the disruptive consequences (Walton & McKersie, 1965). The parties involved are more likely to confront disagreements and solve them instead of smoothing them over. High trust relationships facilitate open and honest communication and therefore are able to confront the counterpart with 'harsh truths', without being afraid that it will permanently damage the relationship (Zaheer et al. 1998).

2.3.3.3 Underestimation of opportunistic behavior

Whilst trust can reduce transaction costs, it might also lead to an underestimation for the other party's willingness to act opportunistically. Trust is based on, among other things; one's own cognitive impression of the other party. Transaction cost economics is based on the notion that people act in self-interest. Trust then might lead to less monitoring, hence giving the counterparty chances to act opportunistically (Nooteboom, 1996).

2.3.3.4 Trust is vulnerable

Trust is costly in the sense that it takes time and effort to build and maintain. Cvetkovich et al. (2002) showed that negative information has a much stronger effect on decreasing trust that positive information had on increasing it. Negative information triggers stronger reactions that positive information, showing that there exists an idiosyncrasy between the ease of destroying trust and the difficulty of creating it (Cvetkovich et al., 2002). All though negative information has a bigger impact on trust than positive information, the effect of the information will vary based on the trust the receiver have to the messenger.

2.3.4 Calculative and Relational Trust

Agency theory is based on the economic theory where individuals are seen actors seeking to optimize outcomes that are in their interests. This also affects how trust is viewed within this context. Williamson (1993) utilize game theory to distinguish between personal trust and calculative trust. A prerequisite for his understanding of trust is the view that it is purposely calculated based on the benefits and costs of the other individual's potential cheating. He defines calculative trust as:

> (...) A situation in which the affected parties (1) are aware of the range of possible outcomes and their associated probabilities, (2) take cost-effective actions to mitigate hazards and enhance benefits, (3) proceed with the transaction only if expected net gains can be projected, and, (4) if X can complete the transaction with any of several Ys, the transaction is assigned to that Y for which the largest net gain can be projected (Williams 1993, p. 467)

Williamson (1993) argues that this sort of trust is prevalent in business relationships, and should be mitigated by contracts safeguarding opportunistic behavior. When the trustor perceives that the trustee intends to perform a beneficial action trust emerges. This is similar to deterrence-based trust, which is characterized by utilitarian considerations that enable the trustor to believe that the trustee is trustworthy, because there are costly sanctions in place that exceeds any potential benefits from opportunistic behavior (Rousseau et al., 1998). However, where deterrence-based trust is present because control-mechanisms reduces the potential benefit for opportunistic behavior, calculative trust also incorporates an information dimension where the actor seeks reliable information regarding the competence or intention of another (ibid).

Williamson (1993) defines personal trust as inimical to calculative trust:

> I will take it that X responses personal trust in Y if X (1) consciously refuses to monitor Y, (2) is predisposed to ascribe good intentions to Y when things go wrong, and (3) treats Y in a discrete structural way. Conditions 1 and 3 limit calculativeness. Under condition 2, "bad outcomes" are given a favorable construction: they are interpreted by X as stochastic events, or as complexity (Y didn't fully understand the situation), or as peccadillos (Y was inebriated) (Williamson 1993, p. 483).

Personal trust is in William's (1993) view only reserved for friends, family and lovers, and the need to monitor is therefore lessened. Personal trust is similar to Rousseau et al.'s (1998) understanding of relational trust. Relational trust is here understood as a result of repeated interactions over time between trustor and trustee. If the results of the previous interactions have been satisfactory, the trustor will form positive expectations about the trustee's intentions. Attachments between the actors form over time. Over time, repeated cycles of exchange with desired results can evolve the exchanges into a relationship, characterized by mutual loyalty and broad support. Whereas calculus-based trust is likely to be ended if the trustor experience violations, relational trust is often more resilient.

Rousseau et al. (1998) argue that control only is needed when the adequate trust is not present. Trust, it is argued, is a substitute for control not a control mechanism in and of itself. One of the bases of trust is that one has a positive perception of the other's motives. Furthermore, Sitkin & Roth (1993) show that contracts made to facilitate trust is not effective. They (ibid) define trust as a context-specific expectancy. They find that contracts can facilitate certain behavior, but if the perceived trustworthiness of the other party is perceived as low, contracts can increase that perception (Sitkin & Roth, 1993). Still, exchange relationships often have some elements of both calculative trust and relational trust. Instead of defining the concepts as inimical, Rousseau et al. (1998) argue that both forms of trust can be mixed together at the same time. Hence, some relationships have more calculative elements than others, while some relationships have more relational elements.

2.3.5 Trust in context of the venture capital industry

Generally, papers on relationships in the venture capital industry have, in the tradition of agency theory, emphasized control mechanisms (Shepherd & Zacharakis, 2010). Nevertheless, a few academics have explored trust in the context of the venture capital industry. Bottazzi et al. (2016) argue that it is attractive to test the effects of trust in the context of the venture capital market because the actors in the market finds themselves in a position with seemingly conflicting rationales. On the one hand venture capitalists are sophisticated investors who should only act when they have access to a lot of information. On the other hand, financing of new companies means limited access to hard information, considerable risks for opportunistic behavior, and high uncertainty. Therefore, soft information, such as trust, could often be an important factor for the investor to invest. Bottazzi et al. (2016) further studied the effect of trust on financial investment and contracting

decisions in the European venture capital market. Their scope was the relationship between the GPs and entrepreneurs, and, furthermore, they studied the effect of generalized trust in a macro perspective. They found that trust significantly affects investment decisions in the venture capital market.

Only a few papers combine agency theory with trust theory. Shepherd & Zacharakis (2010) explored trust, control and confidence in the venture capitalist-entrepreneur relationship. They found that the parties must find the optimal balance between the level of trust building mechanisms and control so that the confidence in the co-operation can emerge. Shepherd & Zacharakis (2010) proposes that the parties can achieve trust in the relationship by being fair and just, signaling consistency and commitment, being just and fair and with frequent and open communication. Trust in the relationship is important because both parties have incentives to act opportunistic. When seeking financing, the entrepreneurs have an incentive to overstate the firm's performance and downplay detrimental information (Bowden, 1994). With the traditional fund structure, which was studied in this paper, venture capital firms would typically only receive their returns after the LPs have received theirs. Venture capital firms then have an incentive to seek short-term profits at the detriment of long-term income (Gomez Mejia et al., 1990). Confidence in the relationship is therefore important to incentivize the parties to act co-operative (Shepherd & Zacharakis, 2010).

Kollmann et al. (2014) was the only article found by the authors of this thesis, combining trust theory with agency theory while studying the relationship between LPs and GPs. In the paper, they (Ibid) focused on institutional investors as LPs, such as pension funds, funds of fund, or investment banks. They explored the LPs' criterion when choosing to invest in venture capital funds. More specifically, they investigate two criteria, the investors' trust in the venture capital firm and the perceived controllability, and their effect on investment decisions. Utilizing quantitative method, their goal is to expand on the traditional view that fundraising is mostly determined track record by the venture capital firm's track record (Gompers & Lerner, 2001; Kaplan & Schoar, 2005; Balboa & Marti, 2007). Kollmann et al (2014) based their understanding of trust on Doney & Cannon (1997) definition of trust as the perceived benevolence credibility of the trustee. Although, track-record plays a critical role, they found that trust and controllability seemed to have an effect on the LPs decision to invest in GPs. Furthermore, they found that track-record did not have an effect on trust, but argue that the reason might be their way of conceptualizing trust.

2.4 THE FRAMEWORK

The authors have developed a framework for analyzing information asymmetry between the GP and the LPs with trust as a complementary perspective to agency theory. The framework is based on the assumption that trust influence how the LPs cope with the information asymmetries that arises between the LPs and the GP a deal-by-deal structure (Granovetter, 1985). The framework is illustrated Figure 3, and is intended to help the researchers answer the research question *how is trust connected to how the investors cope with the perceived information asymmetries in a deal-by-deal structure?*

Trust is chosen as a complementary perspective for examining information asymmetries. The authors have based a large part of their initial framework on the work of McKnight & Chervany (1996), as Becerra & Gupta (1999) recommend redirecting the focus of agency theory from contracting to creating an environment where the possibility of selfish and opportunistic behavior is mitigated through trust between the principal and the agent. Rather than seeing trust and agency theory as opposites, Becerra & Gupta (1999) argue that the theories complement each other. Both agency theory and trust theory builds on the central idea that the context in which relationships take place, both attitudinal and informational, make full trust in another person excessively risky and, therefore, sub-optimal. The difference between the theories mainly lies in the different tools recommended to cope with the asymmetric information in the relationships. The trust is in the network works both a screening device and an information processing device that can contribute to the principal keeping up to date on opportunities and dangers (Burt, 1992; Shane & Cable, 2002). Hence, trust between the parties can reduce the need for costly monitoring (Ferris et al., 2017), playing an important part in reducing information asymmetries. The reason for choosing McKnight & Chervany's (1996) framework is that it encapsulates a higher number of relevant indicators than other existing frameworks, and will allow the authors able to provide a wider and more in-depth analysis of the research question, which is to examine how trust is connected to how the investors cope with the perceived information asymmetries between the LP and the GP.

2.4.1 Modifications

Although McKnight & Chervany's (1996) framework can facilitate a thorough investigation of the research question, some modifications have been made. Two of the constructs from the

original framework by McKnight & Chervany (1996) have been removed: dispositional trust and situation decision to trust. The former is similar to what Granovetter (1985) refers to as generalized morality. Generalized morality is focused on a person's disposition to trust - one either views people as generally trustworthy or one views people as generally untrustworthy. This means that the dimension is seen an individual predisposition, not something that is relational in a specific context. The authors recognize that there exist differences in the individual's predisposition to trust others (Gurtman 1992; Sorrentino et al. 1995), but as this thesis is more focused on the specific situations relating to trust and information asymmetries in a specific relationship, the dimension is cut from the analysis. The other dimension that has been removed, situational decision to trust, is also problematic to the thesis because it is not relational. This construct would in this context entail that an investor would always trust a deal-by-deal structure with their money in venture capital finance.

The constructs that have been modified or added is so because they provide the basis for a deeper analysis of the trust that exists between the investors and Viking Venture, allowing the authors to say something about how trust is connected to the information asymmetries on a deeper level. McKnight & Chervany's (1996) trusting beliefs construction says, in this context, something about the investors' beliefs regarding the trustworthiness of Viking Venture. System trust, in the context studied in this thesis, involves the trust in the deal-by-deal structure itself, not any personal attributes of the other party. A construct relating to whether the trust in the different contexts is calculative or relational has been added (Willamson, 1993; Rousseau et al., 1998). Defining whether the trust that exist between Viking and the investors are relational or calculative is interesting in the context of this thesis, as it can influence how the investors and Viking handle problems with perceived information asymmetries.

2.4.2 Utilizing the framework

To be able to answer the research question, the information asymmetries between the LPs and the GPs must be identified. Problems with adverse selection and moral hazard, which in economic theory are solved through contracts, monitoring and signaling (Gompers & Lerner, 1996), serve as the main factors for identifying perceived information asymmetries. Thus, the first step is to describe the adverse selection and moral hazards the parties perceives as a potential risk, and how the parties, through contracts and incentives try to reduce these information asymmetries. The information asymmetries identified by the investors is an

important underlying part of the thesis, as only by identifying them, the authors can examine how trust is connected coping with information asymmetries.

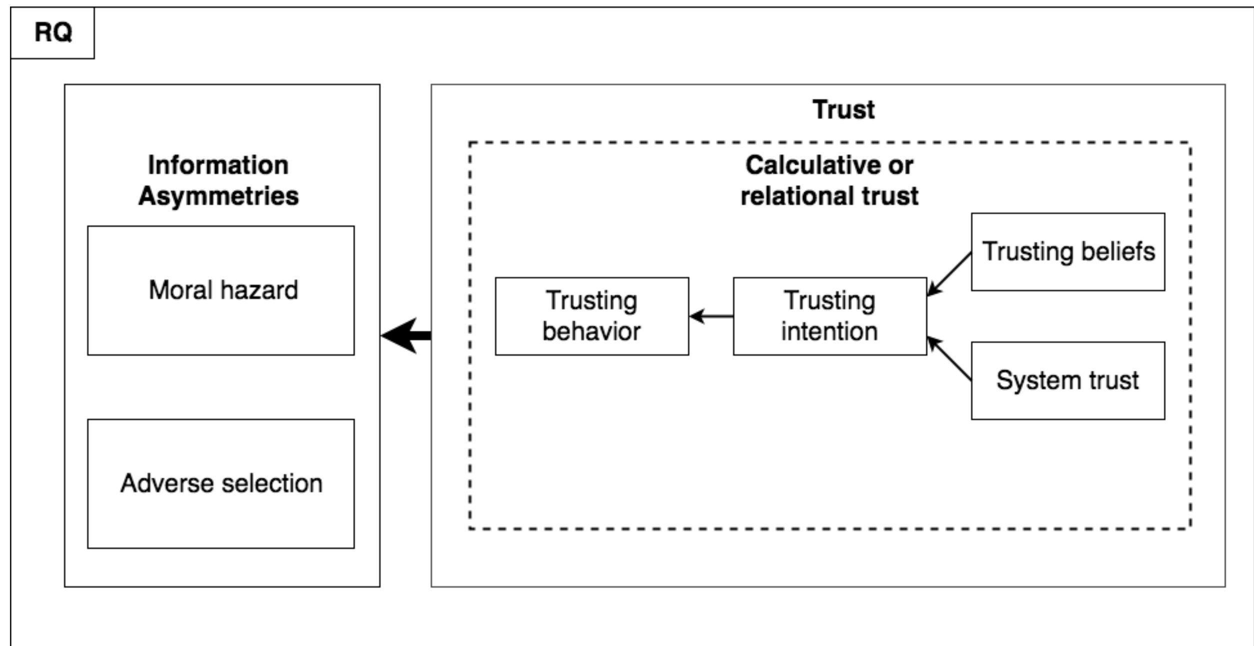

Figure 3: The Framework

However, the thesis is based on papers that find that problems arising because of asymmetric information cannot be solved only by contracts and incentives (Granovetter 1985; Sitkin & Roth, 1993; Becerra & Gupta, 1999; Eckermann, 2006). The next step is to analyze the trust that is present in the relationship and how it informs the parties' behavior. More specifically, the framework is used to analyze how the trust facilitates continued action between the parties when information asymmetries exist. Understanding if the trust is calculative and relational is especially important, as it says something about both the transferability of the system studied, and the relationships' robustness. Further, the different trust constructs have a directional relationship. System trust and trusting beliefs are said to lead to trusting intention, which in turn manifests itself through trusting behavior. (McKnight & Chervany, 1996, p. 26).

The dimension regarding trusting beliefs makes it possible to determine what trust characteristics the parties emphasize in each other, as what characteristics the parties emphasize in each other forms the basis for the categorization. The construction of system trust is helpful when distinguishing between personal and impersonal trust. System trust is more calculative than the trusting beliefs - whilst trusting beliefs are personal, system trust is impersonal and focused on risks rather than trusting beliefs. In the construct of trusting

intention, potential negative consequences and feelings of security are the most important dimension in this context. With potential negative consequences one can analyze to what degree the parties are aware of potential negative outcomes of their relationship and what risks are involved. Situation specific context and dependence are both contextual and inherent in the relationship studied in this thesis. Furthermore, there is an inherent dependence in the relationship (McKnight & Chervany, 1996), as the subjects of this study are already in an economic relationship. The dependency of the relationship is to a larger degree analyzed from the information asymmetry perspective but this is no less relevant from a trust perspective.

Further, when there is a high degree of trust, one is willing to increase the potential losses (Rousseau et al., 1998). This is related to the construct of trusting behavior. Some of the indicators of trusting behavior are intrinsic to the relationship that already exists. For example, one indicator of trusting behavior is committing to a potential loss based on the other person's actions (Narus, 1990). The subjects of this study are already in an economic relationship, which entails to some degree of committing to potential loss. However, there are differences to what degree the potential loss might entail when there exist information asymmetries, and the parties' actual behavior is a more objective indicator of the trust between the parties (Rousseau et al., 1998).

Lastly, understanding what type of trust existing between the parties is important. Calculative trust and relational trust affects how the parties handle information asymmetries (Williamson, 1993). If the trust is mostly calculative, as in based on contracts and incentives, then the system where the economic exchange is embedded is the entity one trust. This indicator makes it possible to say something about the transferability of the system.

3. METHODOLOGY

This chapter presents the research methodology for the master's thesis, which gives an overview of how the research process was conducted. In the end of the chapter, the authors will provide a reflection of the method as well as challenges and limitations.

3.1 RESEARCH DESIGN

The chapter below presents the research design. The research design is based on the research question, as according to Yin (2014) the research design should indicate what questions to study and its propositions. The research question in this study is focused on information asymmetries and trust in a deal-by-deal structure.

3.1.1 Epistemology

Epistemology eventually helped the authors to know what the "truth" in the findings meant in the context of coping with information asymmetries in a deal-by-deal structure. The epistemology is based on the grounds of the interpretivist approach; thus, the main data collection technique of this study is interviews. The perspective relies on the results of interaction between parties, and is qualitative in nature (Sekaran & Bougie, 2013). In addition, the knowledge of the participants is considered relative to time, context and culture rather than being permanent. Hence, it is also important to consider the role of ethics and personal values in the research situation. In this study, the authors have experience with startups and have throughout the study discussed the value and problems related to venture capital finance with several outside actors who might have formed the researcher's opinions. The interviewees have been anonymized for ethical reasons, as their statements in the study might influence their work. According to Saunders et al. (2012), researchers are affected by these values throughout the research process, and it might influence everything from the choice of research approach to the analyzing of the data (Saunders et al., 2012).

3.1.2 Qualitative research

A qualitative research method is favorable when the authors wish to gain deeper insights about the research questions. Since the purpose is concerned with "how" something works or takes place, a qualitative method was the most suitable choice for this study (Yin, 2014). Qualitative interviews are not rigid, as is the case with quantitative research, which suits the

purpose of the study, as it is focused on creating in-depth knowledge of a phenomenon by understanding the LPs subjective perceptions and opinions about a deal-by-deal structure and their relationship to the GP. Furthermore, the authors had little or no control over the behavioral events, meaning that how trust is connected to coping with asymmetric information can be very different from one investor to another, and therefore the qualitative research encompasses these differences. In a broader sense, the aim is to discover new aspects of the subject being studied, in our case how trust influences information asymmetries.

3.1.3 The authors' prior knowledge

Existing research on venture capital structures and -reasoning laid the basis for developing the research questions and the literature review. Through an extensive literature study on factors influencing venture capital finance, the authors discovered that there exists limited research on the topic of both information asymmetries in LP-GP relationships and on new ways of structuring venture capital funds. At the same time, the field of information asymmetries in GP-entrepreneur relationships has been widely discussed by many researchers, and the traditional structure of venture capital funds have also been thoroughly discussed. There are pros and cons with the authors' prior knowledge. On the one hand, too much prior studying might "blind the researcher to important features in the case or cause misreading of local informant's perceptions" (Miles & Huberman, 1994, p. 16), and on the other hand, if the theoretical framework is too loose, it might lead to "indiscriminate data collection and data overload (ibid, p. 17). By using an abductive approach, the authors have assessed their prior knowledge on the field of venture capital, and read new research where it was found necessary to be able to develop a framework, as the "evolving framework is a cornerstone" (Dubois & Gadde, 2002, p. 558).

3.1.4 Exploratory study

The study is formed as an exploratory study as it seeks to ask questions and to assess a specific phenomenon in a new light (Yin, 2014), which fits with the purpose of the thesis. Exploratory studies is useful when researchers lack a complete understanding of an area of research and the authors need new insights (Yin, 2014), in this case information asymmetries between GP and LPs in venture capital finance. Exploratory studies have the goal of explaining the relationships between the variables in a situation, and are especially fruitful in areas where the lack of existing research is scarce. As the authors seek to explore

the relatively unexplored area of how information asymmetries between private investors and the venture capital firm can be managed by trust in a deal-by-deal structure, an exploratory study is appropriate.

3.2 RESEARCH DESIGN

The aim of the master's thesis is to explore how trust is connected to how the investors cope with the perceived information asymmetries in a deal-by-deal structure. The research question has been developed through an iterative process using pilot interviews and initial literature searches. The pilot interviews gave the authors insight that suggested that reduced information asymmetries were key concepts related to a deal-by-deal structure. This concept was then researched theoretically, and developed through the "main" interviews, where trust was found to be an important factor. This is in line with what Dubois & Gadde (2002) calls an abductive approach, as the researches have continually moved between empirical findings and theoretical frameworks.

3.2.1 Case study

What cases to research is a critical issue in any type of case research (Dubois & Gadde, 2014). The authors chose a case study because of the limited focus area of the purpose. The case was identified through a professor at NTNU who suggested that Viking Venture could be a potential case for a study on Venture Capital structures, as they had recently transitioned from a traditional fund structure to a deal-by-deal structure. Viking Venture then provided the authors with the interviewees, which is their investors. Thus, it can also be said that the case "found" the authors. Dubois and Gadde (2014, p. 1280), argue that "the case selects the researcher", as interesting empirical observations can connect the researcher with an opportunity for studying exciting research phenomenon, implying that a non-linear approach can be beneficial for an abductive approach.

The authors chose to conduct semi-structured interviews as it fits well with the purpose of the thesis, and allows the authors to expand their understanding of the research subject (Dubois & Gadde, 2002). The semi-structured interview gave the authors the opportunity to use probe questions when they saw it necessary for the interviewees to further explain or widen their answer (Saunders et al. 2012). This facilitates the possibility to discover new topics that have

not been covered by existing theoretical frameworks, which is a central element for an abductive research approach (Dubois & Gadde, 2002).

3.2.2 Selection Process of interviewees

The authors chose embedded single units of analysis, which is a basic type of design (Yin, 2014). Selecting interviewees among Viking's investor pool was done with a non-probability sampling technique, as described by Saunders et al. (2012). To answer the research questions, the researcher saw it fit to interview Viking Venture's investors. The interviewees were selected in cooperation with Viking, as Viking worked as an intermediary between the authors and the investors. The Managing Partner (MP) of Viking reached out to eleven investors in total, whereas eight had the opportunity to be a part of the study. The final investors were chosen and contacted by the MP in Viking based on the following criteria:

Criteria	Why
Half of the investors must have invested through Viking before the transition to the deal-by-deal structure	It is necessary to interview investors who had something to compare the deal-by-deal structure with to say something about how the structure is different in terms of trust and asymmetric information.
Half of the investors can not have invested through Viking before the transition to the deal-by-deal structure	To examine why they did not invest through Viking before the transition.
At least two investors who have skipped a case in the deal-by-deal structure	To examine the reasons behind opting out of an investment and if these reasons are related to information asymmetries and/or trust.
Based in Trondheim	To be able discuss the findings from a fairly closed off geographical viewpoint. Also related to the practical conducting of the interviews.

Table 1: Selection criteria

Table 2 presents what companies or funds the investors interviewed were invested in. The dark fields represent the cases or funds where the investor is not invested, either because they had not started investing through Viking or because they chose to opt out of the specific investment opportunity. The white fields represent fund or single deals where the investor is invested. As the table shows, four of the investors only started investing in Viking after VV4, the first deal-by-deal case presented for the investors. For more information about the individual investors, see chapter 4.

	VV10	VV9	VV8	VV7	VV6	VV5	VV4	VVIII	VVIIB	VVII	VV
A											
B											
C											
D											
E											
F											
G											
H											

Table 2: Overview over interviewees and their investments. VV-VV10 represents Viking's funds and deal-by-deal cases, while the letters represents the investors.

3.3 DATA ACQUISITION

Yin (2014) urges researchers to use multiple sources of evidence because this allows the investigator to address a broader range of historical, attitudinal, and behavioral issues. Rothbauer (2008) also recommends using a triangulation method as this can strengthen your research and results when different sources of evidence point to the same results. Based on this, several evidences were used in in this study:

- Three qualitative pilot interviews were conducted to find interesting aspects related to information asymmetries between Viking Venture and their investors. The findings from these interviews are not included in the final thesis, but laid the foundation for the final purpose and research questions.
- Eight qualitative interviews were conducted with the investors (as described in chapter 3.3.2).
- In addition to the eight investors, the MP of Viking Venture was interviewed to ensure that the data received was correct and for the authors to better understand the nuances of Viking's deal-by-deal structure.

- Documentation from Viking Venture showing how much each investor have invested in each single case, and, if applicable, investments in previous funds. The document is anonymized and gives a general overview over every private investor invested in Viking.
- Shareholder's agreements between the holding company run by Viking Venture for each company and the investors.

3.3.1 Conducting the interviews

Two of the pilot interviews and seven of "real" interviews were conducted face to face in Trondheim, and lasted approximately 60 minutes. The remaining two interviews were conducted over Skype as the interviewees were out of the country or in other cities in Norway at the time.

As previously explained, the authors conducted semi-structured interviews. The interview guide was revised twice. One guide was developed for the pilot interviews, and then reviewed and revised before the first "real" interview. The interview guide was then again revised after the first interview to make the questions "flow" better. The questions were divided into general questions about the investor and their investments, questions about information flow and questions about social capital and trust. The general questions were asked to make the interviewee comfortable and get familiarized with the setting. As the authors asked questions, they checked the questions off the guide to ensure that all questions and themes had been covered, making sure that they had an overview over the questions being asked. When they saw it fit, the authors used probe questions to make the interviewee widen their answer to enrichen the authors' understanding of the interviewees' opinion.

As recommended by Yin (2014), a voice recorder was used to record every interview, as it enables the authors to focus on steering the conversation and asking the right questions. Saunders et al. (2012) recommend dividing the responsibilities during the interview as it improves the authors' ability to complete the tasks. One of the authors had the leading role in the interview, and was responsible for asking questions from the interview guide, listening actively to the interviewee and asking follow-up questions, and probe questions as recommended by Yin (2014). The other researcher had a more passive role, taking notes, checking off questions and asking follow-up questions the lead researcher might have missed. These roles stayed constant over the interview process.

An interview was also conducted with the MP of Viking Venture to discuss facts tied to Viking Venture and the deal-by-deal structure that the investors might be unsure about.

3.3.2 Documentation: Excel sheet with overview of investors and their investments

An excel sheet with an overview over the investors and amount invested obtained was provided by Viking Venture. This overview has been used as a source of evidence to triangulate evidence as suggested by Yin (2014). In the sheet, the investors have been anonymized, but the amount invested in which fund by which investor is accurate. The sheets were used to examine if there were any interesting patterns and to develop the research questions, and has mainly served as a passive evidence to make cross-references between empirical evidence from collected during interviews as recommended by Yin (2014).

3.3.3 Documentation: Shareholder agreements

To improve the triangulation of evidence, shareholders agreements between the investors and the VV holding company was used to improve consistency across different sources of evidence. This agreement is a contract between the investor and the holding company, consisting of various covenants that regulate the relationship between the shareholders (investors) and the holding company (Viking Venture). The agreement is the same for all shareholders, and is also the same for all the projects funded by Viking Venture. These agreements have served as the basis for examining where there could be possible information asymmetries, and how the information asymmetries differ between a traditional venture capital structure and Viking Venture's structure. However, the main source to information asymmetries have been the interviews with Viking's Managing Partner and the investors, hence, these agreements mainly serve as evidence for the empirical information provided by the interviewees.

3.4 DATA ANALYSIS

After each interview, the authors got together and discussed how the interview went and what were the most interesting topics. Thus, the authors co-aligned their impressions and interpretations of the potential findings in the interview. Each interview was recorded, and the

recordings were stored in the online case study database. All interviews were transcribed within two weeks of the interview. After the interviewed were transcribed, the raw data was transcribed and summarized, and unnecessary fill words removed, as suggested by Dalland (2012). To ensure high quality, the transcriptions were written manually, which is standard for non-standardized qualitative interviews (Saunders et al., 2012). One researcher transcribed the main part of the interviews, and the other researcher read through the transcript to ensure accurate and correct transcriptions, referred to as data cleaning by Saunders et al. (2012). Each transcription was saved as a text file and stored in the online case study database.

Further, the authors categorized the data into topics. One researcher used NVivo to categorize and analyze the data, whilst the other researcher used text documents. In this way, the data has been categorized in two different ways, increasing the research validity of the thesis. The categories were formed based on the literature review and the research questions, but the authors were also open for new findings that would call for an additional literature search. The manual approach to utilize the data started with labeling the data from each transcription and then copy the categories into a spreadsheet where the data was labeled to ensure that the authors knew the origin of the data. The NVivo approach was similar to the manual process. The newest NVivo version (11.3.2.) available for the students of NTNU was used. First the transcripts were imported to the software with the names of the investor as their titles. This way the authors could compare notes later and furthermore, see how long the investor had been with Viking Venture. Then nodes based on the theory were created. The nodes created for trusting beliefs and trusting intention also had subcategories. During the coding process, certain themes not theorized came up several times, for example the investors' relationship with the investment community in Trondheim. Based on these themes new nodes were created. When the transcripts were coded, each node provided a display of all the sentences categorized in that node.

Using this process, the authors were able to reduce the amount of data and rearrange it into categories to provide the best possible answers to the research questions, as suggested by Saunders et al. (2012). Furthermore, the authors were able compare and discuss the labeling of the transcripts, increasing both the validity and reliability. Although the authors mostly agreed on the categorizations, the process also increased both researcher's understanding of the theory as they challenged each other's perspectives and put forward arguments based on the theory when their coding were misaligned.

3.4.1 Alterations between theory and empirical data as part of the analysis

The thesis takes an abductive research approach, which is by Dubois & Gadde (2002) referred to as "systematic combining". An abductive approach is fruitful if the researcher's goal is to discover new variables and other relationships, and the main concern is related to the development of new theory and generation of new concepts, rather than confirmation of existing theory (Dubois & Gadde, 2002). The purpose and research questions were reoriented several times. The authors initially wanted to investigate the value added by a deal-by-deal structure for private investors, but during the pilot interviews, it soon became obvious that the respondents were all speaking of many of the same subjects when allowed to talk freely. The importance of trust in the deal-by-deal structure was clear. After many alterations, the focus of this thesis ended up being to explore how trust is connected to how the investors cope with the perceived information asymmetries in a deal-by-deal structure.

During the systematic combining, the research issues and the analytical frameworks have been altered back and forth when they were confronted with empirical findings. The first phase of alteration gave the authors a new course, as they understood that social capital was an important factor in managing information asymmetries. Thus, the empirical observations called for a redirection of the research problem, and using an abductive approach, the authors needed to find additional theories and new concepts to fill the gaps between the empirical observation and theory. The second phase limited the theory on social capital to theory on trust, as the investors mainly, both explicitly and implicitly, spoke about trust when they spoke about social capital. Thus, the framework was modified, partly because of unexpected empirical findings, but also because the theory on social capital allowed the authors to notice and dive deeper into the concept of trust. This phenomenon is referred to as "matching" in systematic combining (Dubois & Gadde, 2014), and stands in contrast to traditional linear positivist research methods (like concepts provided by Yin, 2014). The discussion concludes with a final moderation of the framework based on the findings from the analysis.

Thus, the authors have both exploited the limited theory on the research area and explored their own empirical findings, resulting in this study combining a deductive and an inductive approach, as argued by Yin (2014) and Saunders et al. (2012). Thus, in line with Dubois & Gadde's (2002) arguments, the abductive approach can be argued to closer to an inductive

approach than a deductive approach, as the interplay between theory and empirical observations has been essential for the end-result.

3.5 REFLECTION AND EVALUATION OF METHOD

Measuring the quality of a semi-structured interview and the data produced all depends on the trustworthiness of the study, including credibility, transferability, dependability and confirmability of the study (Lincoln & Guba, 1985). Also forms of bias will need to be assessed, and Saunders et al., (2012) presents three biases, where the interviewer bias is one of them. The interviewer bias is when the behavior of the interviewer affects the interviewee's way of portraying themselves in a wrong manner and way of answering the questions. To overcome this bias, Saunders et al. (2012) suggest several measures that can be taken and the authors have adapted to this and taken the following measures: 1) the authors read background information on each interviewee to improve their knowledge on the person being interviewed. 2) Information was communicated clearly by using e-mail before each interview. At the start of the interview communication was repeated and the structure of the interview was presented again to prepare the interviewee. 3) The interviewees were responsible for find a suitable place for conducting the interview, unless they specifically asked the authors to locate a space. The interviewees mainly suggested that the interviews were held in their offices. 4) Both a voice recorder and written notes was used during all interviews to ensure the data was sufficiently collected. 5) During the interview, leading questions was avoided as the authors wanted the interviewee to form his answer himself, 6) The authors kept a positive, calm and open behavior throughout the interviews.

3.5.1 Credibility

Lincoln and Guba (1985) claim that ensuring the credibility of the data is one of the most important factors in establishing trustworthiness in a study. The authors used member checks and triangulation to address credibility. By combining in-depth interviews with a literature study and empiric documents from Viking Venture, the authors have strived to triangulate their data. By asking the same questions to different participants in the study, the authors will be collecting data from different sources, and assess the data sources against one another to cross-check data and interpretations. Additionally, the both researchers reviewed the case transcriptions and reported missing factors or mistakes. This can increase validity of the study

by minimizing the possibility for falsely reporting an event or misrepresenting a perspective (Yin, 2014). Peer debriefing involving regular meetings with their guidance counselor and others from the NTNU staff, was be used to discover blind spots and discuss hypothesis and results, as suggested by Flick (2014). It must also be noted that the interviews were conducted, transcribed and analyzed in Norwegian. The final findings and quotes included in the thesis were translated to English. This process might have led to important points getting lost in the translation, and might have weakened the credibility of the data.

3.5.2 Transferability

Transferability concerned with the generalization of the findings in the study to other contexts and situations (Merriam, 2009), meaning if the authors can say something about the likelihood of the same results occurring in other studies. The possibility to generalize the thesis is limited, because the context in which the data is collected defines the data, and it also influences the authors' interpretation of the data. The case is unique because the case company works in with a model that is new in the venture capital market with an investor pool that consists of private investors who are mainly located in the same geographical area as the company.

As the authors conducted a case study with an abductive approach with the goal of examining how trust is connected to how the investors cope with the perceived information asymmetry in a deal-by-deal structure, they hope to contribute to an area of research that has received scarce attention in the venture capital literature (Krefting, 1991). To ensure the transferability of the data the authors have conveyed the boundaries of the research to the reader, including a) the number of persons taking part in the study and where they are based; b) any restrictions in the type of people who contributed data, c) the number of participants involved in the fieldwork, d) the data collection methods that were employed, e) the number and length of the data collection sessions, f) the time period over which the data was collected (Shenton, 2004).

3.5.3 Dependability

The criterion of dependability is related to the consistency of the findings in the study (Krefting, 1991). The main part of the data has been acquired by semi-structured interviews, which allows for dialogue between the authors and the interviewee. However, the environment of the interview situation can affect both the individuals in the interview and the

case situation and data collected. To make the findings consistent, the final interview guide was based on the framework presented in chapter 2. This framework structures the data acquisition to provide comparability across cases. By using their peers and their supervisor, the research plan and implementation was under observation, and the authors strived to receive feedback on the research plan and implementation. By triangulating the data collection, the authors ensured that the weakness of one method was compensated by using other methods for gathering data (Krefting, 1991).

3.5.4 Confirmability

Confirmability is concerned with the concern to objectivity in the qualitative study (Shenton, 2004). As neither of the authors has worked for, been invested in, or received investments from a venture capital fund or in a deal-by-deal structure, this has not posed a big problem. However, the authors are familiar with other people who fit into these categories. To allow the results of the study to be scrutinized, the authors have offered an in-depth methodological description, and demonstrated how the data was gathered and processed during the course of the study, and how it led to the formation of theory.

3.5.5 Limitations

The eight investors interviewed is only a small part of Viking's investment pool and the number is too low to be able to conclude anything with substantial confidence or to generalize the findings of the study. Furthermore, Viking provided the investors interviewed, which might have led to the authors only interviewing the investors most happy with the new structure. But the criterion for what investors the authors wanted to interview was fairly specific. The MP of Viking stated that the ones who were interviewed were the only ones who fit the criterion, giving Viking less of an opportunity to pick and choose the "best" investors.

Furthermore, the literature study has been limited to the databases that belong to NTNU, which may lead to the exclusion of relevant literature. Additionally, the authors' pre-experience in case studies is a limiting factor, as their experience is rather limited. This might have led to the authors not being able to draw the correct conclusions, as the authors cannot know whether the literature collected is enough or the most relevant.

4. THE CASE COMPANY

4.1 ABOUT VIKING VENTURE

Viking Venture (hereby referred to as Viking) is a venture capital firm that was founded in 2001 by Orkla and Gjensidige. Their first fund, VVI (Viking Venture one), was raised in 2001, and four subsequent funds have been raised since then: VVII, VVIIB and VVIII. In 2008, the partners bought out the institutional owners, and Viking is today owned solely by employees serving as partners in VV. In April 2014 Viking changed their business model from a traditional limited partnership fund structure (as described in chapter 2.1.2) to a deal-by-deal structure.

Viking specialize in finding promising technology companies and develop them through active ownership. When they held a traditional fund structure, they invested in a wide range of technology, both in the seed- and growth phase, but in today's deal-by-deal structure they only invest in B2B information technology companies with verified technology and subscription based income models in a growth phase. The companies are expected to expand internationally, and Viking count on an investment period of three to five years before exiting. During the company's lifetime, they have made twenty-two successful exits.

As an active investor, they have four areas of focus. The first is strategy. Viking is especially concerned with the sales process and the pricing of products or services. The second area is recruitment, meaning finding the right people to manage the company and to serve as board members. Number three is financing. In this lie equity, debt and acquisitions. The fourth area is exits: how to sell the company and earn money doing it.

4.1.1 Competition

Viking have positioned themselves in the gap between seed investments and larger buyout investments. Viking states that they have considered about three thousand companies since 2001, and that they have been competing with other venture firms "maybe five times". However, there exist other venture capital firms who operate with a deal-by-deal structure similar to Viking's. The closest competitor identified is Credo Partners, which is a buyout fund located in Oslo. However, as Credo is a buyout fund, they are not indirect competition with Viking.

4.2 THE VIKING VENTURE STRUCTURE

Viking does the due diligence and find companies to present to the investors. Thus, in contrary to a traditional fund, the companies eligible for funding are already located when Viking raise capital from investors. Viking creates a holding company, where all the belongings in the holding company are the stocks in the company receiving investments. The stocks in the holding company are freely negotiable, and there are no preemptive rights. The MP in Viking serves as the chairman in the holding company.

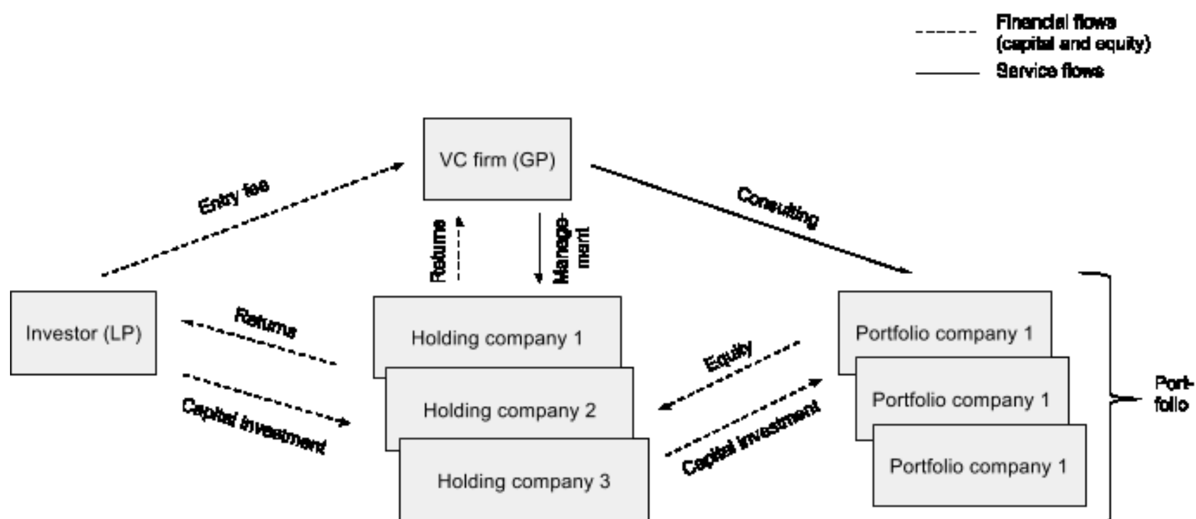

Figure 4: Viking Venture's structure

4.2.1 Fundraising

Capital is raised from the investors on a deal-by-deal basis, where the investors are asked to commit capital a specific company through a holding company presented to them by VV. Before the investment decision is made for every case, the investor is invited to Viking for a briefing on the case, and is given a slide deck containing what Viking believes is most relevant information about the case in question. The investor must commit to the investment within days after the meeting, and can choose how much capital he or she wants to commit. This information serves as the basis for the investor’s decision about whether to invest or not. The investors in the investor pool are asked to, but not obliged to, invest in every portfolio company presented to them by VV. However, if an investor opts out two times in a row, he will not receive an invitation to the consequent presentations, as Viking express that they want committed investors only.

After the investment, a company presentation is held with the management of the company receiving funding, the investors receive quarterly reports from every company they are invested in. If the investor at some point want to sell their stakes before exit, Viking will offer to buy back stakes at valuation price.

4.2.2 Incentive structure

With the new structure, the management receives a signing fee of 15% up front that will cover every cost associated with the investment, including pre-investment, during the investment and after the investment, thus replacing the management carry that was a part of the fund-structure. This fee is returned to the investors with a 7% interest before Viking can share the real upside with the investors after exiting. Viking always take 5% of the total investments in the holding company, leaving 95% of the holding company to the investors. After an exit, the investors get their investment plus 7% for every year of the investment, and Viking returns the 15% paid up front by the investor. After this, Viking get their investment (5%) plus 7% for every year of the investment. Then the money that remains in the holding company is distributed, 80% is distributed to the investors, and the remaining 20% goes to VV. However, if Viking has an investment that only had has a 7% increase in value or less, they will lose their entire investment, and the both the money invested and the returns is distributed to the investors.

4.2.3 Investor characteristics

In the fund structure, two thirds of the capital were raised from institutional investors. In the deal-by-deal structure, however, 100% of the capital is raised from private investors. About 50% of the investors are from Trondheim, and 50% from Oslo. Additionally, they have a small number of investors from the UK and the USA. To invest in Viking, the investors need to be defined as professional investors as regulated by Verdipapirforskriften. Thus, the investors are wealthy individuals who have a considerable amount of capital under management. Their investments in Viking are for most of the investors a small part of their financial portfolio. Table 3 shows the characteristics of the investors interviewed for the thesis. In the first column, the investors are given a letter to symbolize their name. The second column provides a short description of the investors' profession and/or previous experience and what sector they have their background from. The third column gives an overview over whose money they are investing. Private funds refer to private capital or savings owned by the

investor only. The investors investing their family fortune is managing a legacy on behalf of their family and is investing family funds. The fourth column shows the first fund or single purpose deal the investor invested in. VV, VII, VVIIB and VVIII are the names of the traditional funds Viking managed before they changed to a deal-by-deal structure. The holding companies in the deal-by-deal structure are VV4, VV5, VV6, VV7, VV8, VV9 and VV10. The next column shows all the funds and deals the investor is invested in. The final column shows where the main part of the investor's total investment portfolio is placed. As one can see, half of the investors are mainly invested in real estate, and three of the investors mainly invests in liquid assets such as publicly listed stocks. One investor has the main part of his investments placed in PE-funds.

Inves-tor	**Profession**	**Investing**	**Joined Viking by**	**Invested in**	**Main investments**
A	Investor. Former CEO	Family fortune	VVIII	VVIII, VV4, VV5, VV6, VV7, VV8, VV9, VV10	Real estate
B	Retired. Background from finance	Private funds	VV5	VV5, VV6, VV7, VV8, VV9, VV10	Publicly listed stocks
C	Investor. Background from retail.	Family fortune	VV5	VV5, VV6, VV7, VV8, VV9, VV10	Real estate
D	Investor. Former CEO. Background from retail.	Private funds	VV	VV, VVII, VVIIB, VVIII, VV4, VV5, VV7, VV8, VV9, VV10	Real estate
E	Investor. Background from finance.	Private funds	VV5	VV5, VV6, VV7, VV9, VV10	Publicly listed stocks
F	Investor. Former CEO. Background from the automobile industry.	Family fortune	VV	VV, VVIIB, VVIII, VV4, VV5, VV7, VV8, VV9, VV10	Real estate
G	Chairman of the board. Background from finance.	Private funds	VV5	VV5, VV6, VV7, VV8, VV9, VV10	Publicly listed stocks, obligations and funds
H	CEO. Background from retail.	Private funds	VVII	VVII, VVIII, VV4, VV5, VV7, VV8, VV9	PE-funds

Table 3: Investor characteristics

4.3 FUNDRAISING

The change of structure has been successful in regards to capital committed from private investors. The structure calls for smaller investments in each portfolio than traditional funds, somewhere between 30 and 70 million kroner. Private investors have committed more funds to the deal-by-deal structure than they did to the fund structure. Viking's funds consisted of ten portfolio companies. In the fund structure, the maximum sum a private investor committed was 10 million kroner. That equals 1 million kroner per company. In the deal-by-deal structure, the maximum sum a private investor has invested is 23 million kroner distributed over seven companies, meaning the highest average investment sum is over 3.2 million kroner per company. This investor only had an average investment per company in the fund structure of 0,5 million kroner, meaning this particular investor on average has invested six times as much in the companies in the deal-by-deal structure. According to our calculations, the average investment sum for private investors in the deal-by-deal structure is over three times higher than the average investment sum for private investors in the fund structure. In addition, the fact that the number of private investors has grown from 15 to almost 60 must also be taken into consideration. If one only accounts for the fifteen original private investors, the average investment sum per company is more than four times as high in the deal-by-deal structure than in the fund structure.

5. FINDINGS

In this chapter, the empirical findings are presented. The chapter is divided into four subchapters, the first three being the three phases the investors goes through when investing in Viking: committing, investing and following up the investment, and the fourth being about the investors perception of trust.

5.1 COMMITTING TO VIKING

This phase is defined as the period leading up to the investors making their first investments. In the deal-by-deal structure the contract is signed when the investors make the decision to invest in a case company. However, before making the first investment the investors orally commit to Viking. That means the investors give their consent to be a part of the investor pool Viking contacts when they have identified a case company. This phase therefore does not include the factors related to the direct investment decision itself as the findings related to that specific event are presented in chapter 5.2. The phase leading up to the investors committing to Viking consists of three important events: the first being the investor gaining knowledge about Viking, the second being Viking pitching the deal-by-deal structure to a potential investor, and the third event concluding the phase with the investor deciding to orally commit to the structure based on the information he has been given. Three main categories were identified as of importance in the findings: the investors relationship with Viking, the investors' willingness to do due diligence on Viking and Viking's reputation.

5.1.1 The investors' relationships with Viking

All the investors explicitly emphasized that the relationship they have with Viking's MP and that they trust in the Viking team.

5.1.1.1 Relationships with Viking's managing partner

The investors seem to especially know Viking's Managing Partner (MP) from various forums. Most of investors said that they had interacted with, or known about, him since Viking's inception in 2001, some had known him even longer. One of the investors knows him personally because a close family member went to school with him, one of them knew him from his days in Orkla, two of them sat in the same office space as Viking, and two of them claim that they have known him for a long time, but cannot remember for how long. The

remaining two investors mainly got to know about his reputation through the investment community in Trondheim. When asked if he have a personal relationship with the MP, investor C said: “Yes I do. We have something called (a club) in Trondheim. He is a member there, and so am I. To become a member, you must have a very clean record, to put it that way” (C). Although the investors’ relations with the MP are mainly professional some of them mentions some social arenas where they meet him. Several of the investors mentioned meeting him at a forum for investors. Investor C also has a close family member who has known the MP for a long time, and he based much of his initial trust in Viking on information provided to him by this family member: “[family member], who has known [the MP] throughout his life, since first grade and all the way through school, told me he was at the top of his class, only receiving A’s. Enormously competent guy. And he has always been dedicated to the things he has worked with. I have a great deal of trust in him, both as a person, his knowledge and on his ability to execute”.

5.1.2 Viking’s experience

The fact that the management team has held together for many years is also token of quality for many of the investors, who believe that a management that has worked together for that long must have learned some important lessons along the way. “They have worked together for many years, and I think they burned themselves a couple of times along the way. I think they learned a lot the first ten years, and for us who entered Viking later, it seems like they have had a decent development”. It also is worth noting that every one of the “new” investors, meaning the investors who were not invested in Viking’s fund structure, joined Viking as soon as the changed from a fund structure to a deal-by-deal structure.

5.1.2.1 Experience is regarded as important

It seems like the experiences Viking has taken with them from the fund structure has been an important factor especially for the “new” investors. One investor stated, “Their experience is starting to become substantial, at least compared to the experience they had when they started out. They have built competencies and probably an ability to create value. They have a good network and they are relatively unique in Norway in their domain”. Most of the investors also said in some way or another that their views on Viking and the MP have been shaped over time as Viking has gained more experience, and that they trust in Viking’s competence: “It was not until they came with their third fund that I found the time right to look a little closer.

Since then we have had a very good relationship, and they are certainly delivering. And it's very much because of the results it is interesting for us to be part of what they're doing" (A). Some of the investors argued that the team's experience was an important source for their trust in Viking: "They have indeed delivered, they have lots of experience now, unlike in the beginning, they have been doing this for a while. So, they have built competence and an acceptable ability to add value. (...) I think there are many reasons why they can do well with these new funds" (E). In line with investor E's reasoning, most of the investors trust Viking's competence: "You feel that they are competent people when you hear them speak, or present a case, or hear about them among others. You make up your mind, because they are what we invest in. We invest our money in Viking Venture's expertise" (H).

5.1.2.2 Some of the investors take pride in having stood by Viking for a long time

The group of investors who have been with Viking since before the deal-by-deal structure seem to take pride in the fact that they have stood by Viking along the way. Investor D jokingly said that "I like to say that I helped pay for their education" and that the reason he says that is that that he has contributed to them learning how to be a venture capitalist firm. They have developed a network both nationally and internationally, they have made exits and they have made mistakes and gotten through it: "Now they are stronger than they were when they started, in a segment that is easier to read with lower risk". Investor D even stated that he even trusts Viking on giving advice on investments he holds elsewhere because of their track record and competencies. "Every time they make an exit they get... I guess you can call it status? A track record. And they take away some valuable lessons they can apply to the next companies. They are getting really good at that. You know, I have had some meetings with them about other companies I'm invested in just to get some advice". Other investors also emphasized Viking's reputation as orderly and honest. However, a reputation is not only valuable to the investors, it is also valuable for Viking. Some of the investors think Viking is concerned with their reputation, as it gives them easier access to money. Investor D said: "I mean, they want to have a decent ROI, build a track record and... But of course, they have their own goals as well, building their reputation, getting easier access to money. Of course".

5.1.2.3 The investors talk to other investors about Viking

Several of the investors said they had talked to others in the investment community about Viking before investing: "Trondheim is very small. And those on the shareholder list are

mostly familiar. (…) Their model of business is known, not just through Viking Venture, but through other structures that I am familiar with" (C). Investor G shared the sentiment that he got an impression of Viking through other channels than just Viking's own: "There are so many other contact points where Viking is in the market, where I get an impression of their reputation and what they do and how they are seen by others".

5.1.2.4 Management capacity

Some of the investors expresses concern with Viking's management capacity and are worried that they might take on too many projects to be able to have the same level of execution. One of the investors has voiced his opinion to the MP of Viking, whilst the others have not. The concerns are based on a fear that Viking's portfolio of single-purpose cases will grow too big and that the small team in Viking won't be able to spend sufficient amount of time on each company.

5.1.3 Business model

The investors highlight the business model as a key attribute of the deal-by-deal structure.

5.1.3.1 Industry specific focus

In the fund structure previously pursued by Viking, the companies were spread out through different phases and different industries, but the deal-by-deal model is focused on companies in a specific phase within a specific industry. "I think they might have had some covenants on industries or something in Viking Venture III, but before that, I felt like it was a bit more "lobster or canary", so to say" (D). Investor C stated that the deal-by-deal structure reduces risk: "Viking entered this model, and they only invest in companies in the oil- and computer industry with a subscription based income model. I think that's great. They companies are up and running, with incomes and costs, and a positive bottom line, which makes it interesting".

Because of the nature of the structure, the investors know the specific company presented to them, as opposed to the previous fund structure, where the investors invested in an "empty fund" and had to wait for Viking to locate the right companies and invest. The investors are in total agreement about this. An example is investor B who stated that "the companies searching for funding is laid out before you, which is good. That means you can dive right into the company, instead of Viking asking for your money without knowing what they are

going to invest it in". This might be one of the findings that have received unanimous praise amongst the group of investors being interviewed.

5.1.3.2 Risk

However, the investors agree that they should invest in (close to) every company presented to them by Viking to reduce risk. "If you chose to only invest in one, the risk is high. But if you do like us, who are invested in a lot of single purpose companies, the risk is diversified. And there are some companies that have gone well, we're talking four, five times the original investment, and then there are others that struggle to increase much more than the entry value. But as long as the sum of the companies can be regarded a portfolio, the risk is reduced" (A). Some of the investors argue that the potential upside of the investments is lower than in a traditional fund, but that the mitigated risk makes up for this. "The risk is much lower, Viking has seen that as well. Easily told, you get more for your money. Even if you don't get the ten-fold, you get three or twofold adjusted for risk. Which to me is better" (D). One of the investors even argued that it would take a lot for the value of the company to decrease to a point where it is no longer valuable, in contrast to the companies in the previous structure, where a failed technology in a company could be alpha omega. "The risk is extremely much lower. In the funds… If the technology didn't work, the company wasn't worth anything at all. I mean, then one just had to lie down and say "sorry, that didn't happen. Bye". But these new companies that have come with the deal-by-deal structure is operating companies that actually earns money, which makes the risk associated with the company much smaller, because there will be a value there even if things doesn't turn out like planned" (H).

5.1.3.3 Timeframe

In general, all the investors seem to be attracted by the time frame of the investment. As opposed to in the fund structure, where the investors often had to wait 10-15 years for the investment to be returned, the investments in the deal-by-deal structure are supposed to reach an exit within 3-5 years after the time of investment. The timeline in fund structure was by many of the investors perceived as too long. Investor H uttered a point related to the timeframe of the investment: "Those of us who have invested our own money like to see that something becomes of it. It's nicer to get a ROI and then re-invest in something new. We think that's more fun than sitting here waiting for something to happen for ten, twenty years". The investors also express a general dissatisfaction with the timeframe for the previous fund

structure. One of the main reasons the investors were dissatisfied with the fund structure is that it took too long to realize the assets and that they did not receive enough information during the time from investment to exit. “It takes a long time to get answers about Viking I, II and III. Viking II is entering its tenth year or something… That’s a very long time in that part of my world” (F). Investor H claims that “By entering a fond, you don’t really have any “control” over your money. You commit to a sum, and then we’re talking maybe five years plus extensions, so in total we’re looking at a time horizon of eight, nine, ten years”, which is a statement representative for the opinion of most the investors interviewed. In general, the timeframe of the investment seems to have been a big determinant for the investors choosing to commit to the deal-by-deal structure.

5.1.4 Summary

A majority of the investors had existing relationships with Viking when they decided to enter the deal-by-deal structure. The investors explain that they have conducted due diligence on Viking mainly through their network. As Viking has become experienced they have developed a solid reputation, which seems to have influenced the investors opinion on Viking and their trustworthiness. Furthermore, the business model is found to be more attractive to the investors than before. The main reason for this seem to be related to the industry specific focus, the decision-making authority of the investor related to the investment and the investment sums, and the time frame of the investment, which all is perceived to lower the information asymmetries between the LP and the GP.

5.2 INVESTMENT DECISION

The investors who decided to commit to Viking in the first phase must in this phase decide if they want to invest in the cases presented to them by Viking. Thus, this phase is defined the phase leading up to the point where the investors make the decision to invest in a case in the deal-by-deal structure. The moment the investors decide to invest in a company is the first time they sign a contract with a holding company managed by Viking. This phase consists of six steps. First, Viking performs thorough due diligence until they find a company they are willing to invest in. The second step consists of Viking negotiating an investment deal with the company. Third, when the deal is made Viking meets with the investors individually. During the meeting Viking present information about the company they have made a deal

with. The investor has the possibility to ask some follow-up questions, before making his/her decision. After the meeting the investor makes the decision on whether to invest or not and the size of the investment sum. When Viking have completed presenting the case to all the investors in their investment pool, they evaluate if they must shorten the individual investments made by the investors. Lastly, Viking receive the capital from the investors, and the investment is made.

5.2.1 Due diligence on case companies

There seems to be a consensus among the investors that the investors don't have the relevant competencies to "be more involved" or to review advanced industry specific about the case companies eligible for funding. Thus, the investors generally don't do further due diligence on the cases presented to them by Viking, but trust Viking's decision. Investor F stated that "You know, entering the field of high tech business is nothing for me. I don't have the capacity to do that, and I don't have the competencies either. Viking take care of that for me". The investors generally expressed a predilection for accounting numbers, expected ROI and numbers focusing on the expected future of the marked, and they admitted that more technical information about the details of the products, which all are categorized as software as a service, probably would go over their heads: "The investments are all about computers and stuff. That's miles away from my area of competence, ha-ha!" (F). "Its computer and oil related. That that's not even close to my core competencies, so I'd say that Viking has the best competencies there. (...)" (C). Investor H highlighted the fact that the he doesn't have the abilities to verify if the technology works or not, and that he has to trust Viking and the company receiving funding. "We can sit and listen to them tell us about the technology and find it fascinating, interesting and exciting. But we don't really have the skills to verify if that technology, you know, actually works. (...) As someone who is on the outside and is lacking the right competencies, we don't have the possibility to overrule, say, a professor, about the technology. So, you just have to get this feeling that is sounds about right and trust them". However, he further noted that the new business model mitigates this problem, where the focus is on companies with verified technology.

Investor D stated that "I would never invest in the companies I invest in through Viking Venture directly because of my capacity to do the screening job, which I know is very demanding, both regarding the business model, the product, the competition… All of that".

However, one investor (E) disagreed with the others. He specifically stated that he made his own analysis, sent the MP of Viking emails with in depth questions about the companies considered for receiving funding, and that he wished the reports about the investments had more details: “It doesn’t have to be that much more, but five to ten more slides about the company would be great. (...) Some more information about the accounting conditions and the historic numbers for the company would be appreciated. Like, are there any special occurrences that affect the numbers? And so on”.

5.2.2 The investment community

The investors seem to be a part of the same network of investors in Trondheim, which influences the information the investors receive about Viking.

5.2.2.1 Information in the network

“Trondheim is a small world. People talk. Everyone knows absolutely everyone investing in Viking. And that affects the information you have quite a lot. When I am presented with a case, I listen to what Viking has to say, and I listen to the company searching for funding, but I also talk to other investors that I know has received the same information. And then we say “so what did you think? Do you think it has potential?” So, it’s an important exchange of information, no doubt about that” (H). When asked about this network of investors, investor B answered: “I know many of them, because they are mostly from Trondheim. Trondheim is a small town, and the community is especially quite small” (B).

The investors especially mention a forum for investors in the area as an important arena for meeting other investors. “There is something in this town called (*the forum*), and a lot of the people invested in Viking are members there as well. And at that forum we talk. We can talk about the specifics of the funds or the companies, but also about Viking” (A). Further, it seems that the investor community in Trondheim have a great deal of trust in Viking: “My impression is that they receive a great deal of trust from the investor community in Trondheim, or Trøndelag. (…) All in all, I have not heard of anyone who has doubted their sincerity or good effort” (B). Investor F further expressed that he was not very concerned with his investments in Viking, and that the main reason he is involved is to support the local investment community in Trondheim. “I am concerned with the community in Trondheim and

that it develops in the best possible way. The investments in Viking are what you can call "indulgence", you know, me saying, "here's some money to help develop Trondheim" (F).

5.2.2.2 The network as a control mechanism

Most the investors were clear on the fact that they appreciate the opportunity they have to talk to other investors in the community, and that it influences their decision to invest or not. Investor G explains: "I like to listen to what others are thinking about the cases. I have discussed at least two, three cases with others to find some common grounds before we make the decision". Investor H states "Sometimes I reach out to hear what others think about the case. Of course, that affects my decision". Investor E believes it feels safer for the investors to know that others are a part of the same investment, and to know that you're not the only one who have reached the conclusion to invest: "I know many of them pretty well. I think it affects some of us to know that others are a part of this as well. It makes us safer in our investment when we see that others have reached the same conclusion as we have." (E) Investor (D) stated that he doesn't speak to anyone, but that he understood why other investors might choose to do so: "It's like a "check out". That you're not the only one."

However, one of the investors (A) stated that he doesn't talk to other investors before his decision is made. "I'm not influenced by the other investors anymore, because I usually give (the MP) my answer at the end of the first meeting. When we started, I might have reached out to others to hear their opinions before we invested. But eventually the answer is yes. The answer is yes every time". He further argued that the exchange between the investors didn't lead to any new information: "I don't think us discussing leads to much new information, but you know, we comment and discuss the information we have". Some of the investors think of the network as a control mechanism. "If Viking were to go out on a limb and do something really stupid, the investors in Trondheim would know it pretty fast. Then they can't just come back. I think they will have a problem if they want to do something new. So, it can be described as sort of a social corrective, if I can call it that, in regards to that they can't just go running to a set of new investors in Trondheim, because the community Trondheim is quite transparent" (H). Investor A further stated "The community in this city is small. If anything would happen everyone would be talking" (A).

One investor stated that he suspects that Viking dislike that the investors talk about the cases and deliberate their investment decision together: "I don't think Viking likes us discussing the

cases. I mean, they could have invited a group of investors to make the introduction to the case, but they don't. I think it's a way of controlling the situation" (G)

5.2.3 The structure

The investors exhibit trust in the Viking team, but most of the investors also express that they trust in the system Viking has developed itself.

5.2.3.1 The system

Although the Viking deal-by-deal structure hardly can be separated from the people working there, there seems to be consensus that they trust the system itself. When asked if it is the system or the people in Viking they trust, investor B answered: "Yes, it's them, but it's also the structure they've developed based on their long-standing work. They have a system, you know, for how they do this. They have a checklist they go through, they use external attorneys to help them, and there is system in place. And the system builds trust (B)".

One investor said a close family member of his where on the board of VVII. Asked if he would stop investing in Viking if this family member did not provide him with information he said: "No, I do not think so. It's good to get that information, but no, I do not think I would have stopped. No, it's still the Viking system that has my trust, so I spend the least possible amount of time on it" (F). When asked if he could rate the most important reasons for investing in Viking's deal-by-deal structure, investor F rated his trust to the system the most important thing: "It's what I've said all along, trust in the system, what they present and what they deliver afterwards". Although the trust in the system in general is high, some of the investors also express some concerns relating to different aspects of the system. An illustration of this is what investor D answered when was asked about negative aspects of the structure: "They are dependent on getting paid in advance for everything. But as long as they are investing in the companies themselves, I feel that the scale is tipped back" (D). This is a sentiment most of the investors share, in that they might be critical of certain parts of the system, but that overall, they are in favor.

5.2.3.2 The fee structure

The fee structure in the deal-by-deal structure is different from in the traditional fund structure. One investor stated that there was no doubt that Viking would benefit from the new

structure if the companies are to be successful: “If the investments are going well, Viking will earn a lot, but I don’t mind sharing if the cake is big enough. That is much better than if the cake doesn’t exist”. Several investors share the same thought, but also add that it is fair because Viking are the ones actually doing the job. By other investors, the entry fee is regarded as high, but it is argued that because it is a one-time fee, it is acceptable. One investor also stated that the fact that he feels closer to the investments is intrinsic to the structure, and because of the perceived closeness to the cases, he would rather pay a bit more to be more in control than to go back to a fund structure. Some investors claim that there have been some discussions earlier about the management fees being too high and too expensive, especially for private investors. In the fund structure, the investors paid a yearly management fee on the total committed capital. One investor argued that the old structure “started to feel uncomfortable for many investors” because of the large amounts of money going directly in the pocket of the venture capital firm.

Several investors point out that the structure is noticeable different from the fund structure, where the investors had an incentive to “keep the fund going” for as long as possible, to keep the management carry flowing. The investors realize that the deal-by-deal structure can be expensive for them if none of the firms are realized, but “if the investments meets the standard of the industry, it’s better”.

Three of the investors specifically highlighted the importance of Viking “being in the same boat” as the investors, and others argued that the fact that Viking is invested in the companies is important. The reasoning behind this is that it provides Viking with an incentive to see the investments through and focus on building value, not just “sting investors along for a management carry”.

One investor suggested that it might be a disadvantage that Viking has the incentive to make as many deals as possible and that they might be more concerned with making new deals than creating value in the other cases. At the same time, he suggested that Viking has a positive incentive to realize the investments in due time because they don’t have a yearly management carry. Another investor also admitted that he has thought about the problem with the parties having different information in a case where Viking might want to sell a company to be able to raise more money through a new company, or if they really should wait to make the upside bigger for the investors.

5.2.3.3 Investment opportunities

Two of the investors were adamant that all the investors should get the same offers to invest at about the same time. They thought that all the investors in the Viking system should be rated equal and get the same conditions when they invest: “I would have been a little wary if I discovered that there was a selection of investors” (G). Asked why this is negative, investor G answered: “Then you would get a sorting between the “first investors” and a group number two. I think that would be perceived negatively. That is, I would feel that was negative. (...) If so, Viking creates... I do not think they do this, but then they sort the investors after who gets the best cases”. Investor F said that the sellers in his own business were not allowed to differentiate between his customers, and said that in the same way, he would not accept it if Viking did that. He also used his relation to his bank as an analogy: “As I say to the bank too. You must treat me in a way that makes me feel that no one like me has better conditions. I don’t need to have the best conditions, but I'll have what my position indicates that I should have. If I find that my neighbor, who may have less connection with the bank, has better conditions, it is not very good. (...) If that happens then the trust is destroyed”.

5.2.4 The investors’ decision making authority

The investors seem to like the feeling of control the deal-by-deal structure gives them in the investment process: “I kind of like to say that I am the boss and I that will do it the way I want to do it. Not just place [money] in a fund and let someone else decide” (H). Investor E further explained: “One of them [the reasons why I like the deal-by-deal structure] is that I know what I invest in at the time of investment. Viking brings me a case - a specific company - and all the information I need that belongs to that case including what it is and what is its history. This information allows me to make up my mind about the investment. As opposed to the previous fund structure a black box at the time of investments, meaning I had to have faith that they would come up with a portfolio of good companies, but I couldn’t actually see that portfolio until after my investment. I can choose my own investments now, and I like that” (E).

5.2.4.1 Control over the investments and the investment sum

Even though the investors feel like they have a choice, they also know that they are expected to invest in every case presented to them. However, they like the idea of having the possibility

to opt out of an investment and remain in control over at least part of the investment. “Before they had these funds that they sold shares in. It didn’t really appeal to me. I didn’t have any influence to say yes or no to investments being made in those funds, right. The minute they started changing the way they finance their projects, everything became a lot more interesting” (B). The investors can choose how much they want to invest in the companies presented, and have the chance to control their portfolio. Investor H explained: “I also think the investors like that they can adjust the amount from investment to investment, you know, having trust. It’s a subjective thing, you feel like you make the decisions and think, “I like this, I want to invest this and this much money, and I decide how much”. Investor B explains that the new structure is better, as they are not as obligated to invest in every case: “In a traditional fund, you commit to five million kroners or whatever. And then there is no way back. But now you can say “you know, right now my liquidity is good, I want in” or if the timing isn’t that good you can say “no thank you, maybe next time”. And that’s ok. I think that flexibility is important to us smaller investors”. Investor C agreed, and argued that the deal-by-deal structure gives him control because he can choose the time and size of this investment. “If it doesn’t suit me and my liquidity to invest right now, I can just say no. No matter how great of a company it is” (C).

However, up until now, this has not been a problem. Rather, Viking have had to shorten some of the investments because the investments from the investors has been bigger than the total amount of capital Viking was raising. One of the investors are worried that Viking won’t be able to realize the companies fast enough, and that he is starting to reach his investment cap in venture capital: “(The MP) is concerned with us investing in every company in order to build a decent portfolio and diversify risk. I agree with that, but I also need to be liquid, and I have other types of investments to consider. Six or seven investments in Viking might be my cap. We’ll see. I’m starting to reach about five percent [of my total investment portfolio] now, and I notice that I am becoming more vary in adding more money” (E).

5.2.4.2 No formal agreement to invest in every case

The investors are not bound by any formal agreement to invest in all the cases presented to them: “Formally, I don’t have any obligations to Viking regarding my investments, but it is kind of in the nature in the structure, and it is expected from Viking’s side, that we consider every investment” (H). Investor H further elaborated that this can pose a challenge for Viking as they can get a hard time raising funds as there is no formal obligation to invest, as opposed

to in a fund structure. It is explained to them by Viking that it is important to them that they invest in every case presented to them. They are "allowed" to skip one case, but if they skip two or more in a row, they will not be invited back to invest in the consecutive cases. An interesting statement was made by one of the investors who admitted that he trusts Viking to the degree that he no longer reads through the contracts sent to him before investing, even though he has been fooled before by a major government controlled company. Because the contracts always are the same, the information provided to him by Viking through the initial presentation is sufficient to make a decision and sign the contract.

5.2.4.3 Opting out of an investment

4 out of 8 investors interviewed have chosen to pass on a case presented to them in the deal-by-deal structure. The reasoning behind this varies, but three of the investors specifically mention lack of available liquidity as the main reason. Investor H made an interesting reflection about his choices, and thought he would have thought differently about not investing previously if he knew then what he has learned now: "In retrospect, I think I should have chosen a bit different when I chose not to invest in VV6 (...). If I'm in doubt now, I choose to reduce my investment sum instead of not opting in at all. And if I strongly believe that a case will be a hit I can invest a bit more. You know, regulate my investment sum instead of not joining in. It is all about building a portfolio". However, the fourth investor just wanted to make a statement. He said, "I had to make a statement. They can't just come waltzing into my office, almost believing the investment is good to go before they walk in the door and get a million kroner every time. I just had to put my foot down to make a statement. Turns out that was a dumb decision, the company I turned down turned out to be the best one so far (F).

5.2.5 Summary findings in the investment decision-phase

The investors, apart from one, does not conduct further due diligence on the cases presented to them by Viking. They use the investment community as an important source for information about both the cases presented to them and Viking. Thus, the network works as a control mechanism for the information provided to them by Viking. Furthermore, the deal-by-deal structure in itself is important, as the investors trust in the structure. They are satisfied with the fee structure, and argue that they are more "in the same boat" now than they were in the fund structure.

The investors' extended decision-making abilities leads to a feeling of control, which is appreciated by the investors. However, they acknowledge that the fact that there are no formal agreements for them to invest in every case can pose a risk for Viking, as it can influence their ability to raise funds. It was found that the main reason for opting out of an investment for the investors interviewed was because of their liquidity situation at the time of investment. Hence, the main reason to opt out is not related to the information received about the cases, but a factor external to the structure.

5.3 FOLLOW UP

The final phase is the following period after the decision to invest in a case company has been made. When the first investment has been made, Viking starts managing the investment, providing counseling and value adding activities to the case company. In general, the investors have little insight in this management process. However, they receive quarterly reports from the case companies they are invested in. Furthermore, Viking organize annual meetings with the case companies where the investor can ask follow-up questions to the reports and the information provided to them by Viking. Viking's strategy is to invest in two to four companies a year. Hence, they are in a continuous due diligence process while at the same time managing the companies they that have already received investments. Viking's goal is that each case company should be exited within three to five years. When an exit is made, the investors get the returns of their investment, and their 15% one-time entry fee is also returned with a 7% yearly interest rate.

5.3.1 Following the development of the single companies

Many investors emphasize that they prefer the deal-by-deal structure to the traditional fund structure, as information about the companies they have invested in is more available to them. As opposed to in a traditional fund structure, it is possible to see the development of each case, not just the portfolio as a whole, which again opens for the opportunity to request more information about a specific case. Investor B illustrated this: "The value of the information given after investment lies in my comfort zone. I would like to know how my money is doing, and if it were looking really bad, you'd take a trip to Viking to get more information. So, it's something about that information that is very valuable, because you can act to your own

satisfaction. If it gives any results is another discussion, but it is something about the fact that you want to know how your savings are doing" (B).

Investor A stated that he trusts in Viking and what they do, and that the information received is sufficient: "I pay attention to the developments of the portfolio and I get my quarterly reports. That way I can see if we're at eighty or one hundred and twenty percent. That's enough". According to the investors, Viking should spend their time developing the companies receiving funding, not answering to investors. Investor B argued, "There's something about it... If everyone shows up knocking on their door asking what's going on all the time, they lose speed. They'd spend their time on us instead of the companies they are supposed to develop. So we have to trust them, let them do what they want and leave them alone for them to be able to do what is important". This logic is repeated by several of the other investors.

Although the investment varies between three hundred thousand kroner and 9 million kroner, the investments in Viking in general only accounts for 1-10% of the investors total investment portfolio with the weight on the lower half (about 5% and less). Most of the investors interviewed have other priorities in their day-to-day life than following up on their investments in Viking. A majority of the investors are not interested in actively following up the case companies. "I don't actively follow up the investments on my own. I don't do my own analysis or anything. (...) I have a lot of investments and if I'm going to spend that sort of time on every single one, I wouldn't have time for anything" (E) Investor F clearly stated that he has a small challenge because the investments through Viking is something he does on the side. He spends his time doing "entirely different things than what we are talking about here". Other investors expressed that their investments in Viking are relatively small in comparison to their total investment portfolio, which affects their need for monitoring the investments: "These investments are relatively small in my total portfolio. So, I contribute a bit to each company, but it doesn't show on my bottom line by the end of the year. No matter how good the ROI was that year, I'm not really affected. I mean, I just like the system and the people, that's why I invest" (F).

Some investors explain that they don't talk to other investors about the progress of the investments they have placed in Viking. Investor F states that "It's just money. I don't talk to them. It's about the time I have available. I don't have the time and capacity for that", while

investor C claims that he rarely talks to others about his investments in Viking because of the size of the investment: “For me, the investments are too small for me to care about them in my daily life. I must admit that. I spend my days investing in real estate, and I spend my focus on the investments that are loan-financed. That’s what I’m concerned about. Not financial equity investments. They are just there”. Investor C further elaborated that he thinks his investments so far is a relatively careful investment compared to his total investment portfolio, but that if his investments in Viking in the future were to make up a bigger part of the portfolio, he would like to “sit a bit closer to the investments and be provided with more information”.

5.3.2 Vikings’ performance

Some of the investors emphasized the experience they have had with Viking after they started investing as something that have confirmed their beliefs about Viking: “The whole system seems very orderly and proper. I think they are concerned about having a nice reputation. I do not think they are making mistakes there. I am feeling fairly confident that they are doing things in a proper manner” (F). Investor C emphasized Viking’s ability to tell the truth as a reasoning behind trusting in their performance: “It is important that you have people who are honest and who can actually admit that they are doing the wrong thing. I do that too. I often make mistakes myself and being able to admit it is important” (C).

Although the investors trust Viking and its team members, they also explicitly expressed that they did not have patience if they were to see something they believe is a breach of trust. “I may be a little naive in terms of trust. As I meet people and start talking with them, I start to trust them. But they must make sure they are worthy of my trust, and if they violate it then it's over” (A). There seems to be a general agreement between the investors that the other party must earn their trust. As investor B noted: “It doesn’t take much to lose trust. It takes time to build trust, and it is easy to tear down, some says”. The investors all share some version of this sentiment.

Half of the investors interviewed referred to specific cases where they lost trust in someone they had business dealings with, both in business dealings in general and in the venture capital industry. Investor C had this example: “I've previously invested in a private venture where you entered as a shareholder in a company, and where you thought that the balance and the budgets were intact. Then, overnight, everything was changed. That is not particularly

trustworthy behavior”. In general, they seem to agree that withholding information is the most important source for them losing their trust in Viking. Investor E was particularly concerned with this issue: “If the companies start to go bad then it is important to distinguish between (1) was because the assumptions have changed along the way, that is, there have been surprises in the market, which means that this could not be predicted or that this is such an external factor that one cannot predict it. (...) (2) What is clearly negative is if you come up with information at the time of my investment, which turns out to be incorrect. (...) Then it may become a matter of responsibility. If we have been given numbers or information that later prove to be wrong, and that someone should have said more, then there is a breach of trust.”

Although the investors expressed that trust to some degree can be easily lost, they were also confident that Viking would not do something that would make them lose their trust. Talking about the contracts between the investors and the holding company, one investor pointed out the following: “It is an agreement that I have stopped reading, because it is the same every time. I trust them to such a degree that I do not go in and read it piece by piece. I assume that it’s fine (A)”. Others argued that Viking would have nothing to win to act opportunistically. Investor G argued that the investors would pick up on dishonest behavior quickly, and that would be the end of their relationship with Viking: “If there's a fishy investment I'm not going to involve Økokrim. If something starts to smell and is based on facts, then they've dug their own grave. But they would never do that” (G). Investor A went on to say that Viking acting opportunistically would be much more damning to them than the potential benefits. Furthermore, investor B argued that Viking would have to make some gross mistake before he lost trust in them, although he acknowledges that trust in general can be easily lost: “My impression is that they have a lot of trust in the investor community in Trondheim. They’d had to do some seriously stupid stuff to lose that. I think they are making good money on what they are doing. (...) And that's good, because then there's no reason for them to do anything stupid. They’d had to do some seriously stupid stuff to lose my trust. Or no, actually, it doesn’t take much to lose trust. It takes time to build, but is easy to tear down. However, I don’t have any reason to believe they would be that stupid” (B).

All in all, the investors are satisfied with Viking’s performance. Some investors noted that they still didn’t know the outcome of all the funds, and that some of the funds most likely wouldn’t turn out as planned. However, they didn’t blame the Viking team. “I have never

heard about anyone being dissatisfied with the efforts of the people working in Viking. They can do a great job, and the investment can still turn out to be bad, you know" (B). Investor C stated, "as long as they have a track record and is honest enough to say, "some projects failed, we learned from that, and now we're trying to take that learning and do something else", I believe in them (...)". Trying to explain why he continues to trust Viking with his investments, one investor stated, "It is [the MP's] way of working. He has worked with Viking for many years. He has managed to develop and stay robust in his concept and how he thinks" (C).

5.3.3 The timeframe of the investment

The investors seem to agree that a time horizon of three to six years for the investments is expected, but that anything longer than this can become a problem: "You have to be a part of it until it reaches an exit. You have to be prepared for that. And that can take some time, everything from two, three years till four, five, six years. It shouldn't take longer than that, that's the part of the concept" (B). One of the investors (F) stated, "It is not investments made for life, these investments. It's not your pension fund. It's strictly business, and it needs to live a normal business life, which to me is about five years. Not more. It needs to keep on rolling".

The timeframe of the investment influences the investors' liquidity and the investors' possibility to re-invest the assets: "If it's just a huge fund being renewed and renewed when you originally had planned on re-investing the proceedings in something else... I mean, of course that too it's about liquidity" (D). The investors' opinion on whether the assets invested in Viking is regarded as liquid varies. Investor B stated, "In my opinion, the investments aren't liquid. You can probably sell a post if you really need to, but I haven't heard of anyone who has done that". Other investors know that Viking will buy back shares at value, and consider the assets as "semi-liquid". Additionally, an investor tells a story about rumors related to the fund structure and the fact that the investors were starting to get dissatisfied: "I think one of the previous funds were extended without the management carry because the investors said that enough is enough. You don't have to deal with that in the deal-by-deal structure. It might take some time, that's fine, but at least you won't have to pay a management carry" (D).

Investor D stated that if Viking could produce satisfying results, the trust in Viking would sustain, but that the investors would become restless if it took longer than three to five years. Investor C agreed, and claimed that "Even though the list of investors may not speak to each

other that much, we will become impatient if we do not get some returns within three to five years. Either we look at it in terms of dividend or resale. If not, Viking Venture lose my trust". However, the investors disagree when asked if it is more important to them to get a ROI within the specified time-period or to stay put a bit longer to get a better ROI in the long run. It seems to be a question of how many liquid assets the investor has available to them. The investors who have been invested since before the deal-by-deal structure seem to be interested in staying put a bit longer if there is a potential upside, while the investors with smaller investment portfolios are more determined on the pre-defined time horizon of three to five years. This was illustrated by Investor A who said, "If I'm going to be invested in every company, my timeframe is five to seven years. But if I have the choice of remaining invested for a bit longer to get a bigger upside, I will wait longer. Unless I need the money, of course". Investor H argued that at one-time or another, the management in Viking will have an interest in staying invested for a couple of more years if the upside is big enough: "it's a trade-off". A risk related to this is voiced by several of the investors - the danger of Viking staying invested in a bad company too long: "In retrospect, it's often easy to see that you try and try to make something work, and you keep pouring money into it because if "they just adjust that and that, they can make it work". But no. It didn't work, and instead of spending money on the companies that are actually good and make them amazing, you spend a fortune trying to save something from the grave" (H).

5.3.4 Summary findings post-investment phase

In conclusion, the investors feel that they receive sufficient with information from Viking about the case companies after the investment has been made. The investors trust in Viking's abilities, and have faith in the fact that Viking is doing their best even though the investments might not turn out to be successful. Furthermore, the timeframe of the investment is an essential part of the structure. The main portion of the investors will not allow the investments to be extended, and has an investment horizon of 3-5 years, which is in line with Viking's promises on the subject. The investors who have been invested since the fund structure, however, can stay put a bit longer if it leads to a higher ROI.

5.4 PERCEPTIONS OF TRUST

The investors were asked what they mean when they use the word trust, and they had similar views on what trust entails in a business relationship. All the investors mentioned the importance of orderliness and professional competence in a business relationship. They expect that the information they receive from the other party is correct and that they get all the information they need to make an informed decision. This is illustrated by investor C's view of trust: "Trust, it goes without saying that (...) from that moment you have an investment opportunity and request a meeting, you will find a time to meet, that you meet on the agreed time, that you provide the correct information, and that there are actually real facts in that information, including the information you receive afterwards". In line with this focus on honesty and information, investor G also emphasized that the other party must be willing to share information that might put them in a bad light: "What they tell is important. What they do not tell, we do not need to know, and to the extent that there is something to hide, it should not be hidden. And if things are not going well, then say it. And if things are going well, please say so. If there is something we should have known, then be open about it".

6. ANALYSIS

In this chapter, the findings are analyzed through the framework presented in chapter 2.3. Both moral hazard and adverse selection problems result from the parties' information disadvantages prior and after the initial investment decision. In this chapter, the framework will be applied to examine how trust is connected to how investors cope with the perceived information asymmetries in a deal-by-deal structure.

The analysis will be focused on the three different phases presented in the previous chapter, namely information asymmetries in 1) the phase where the investors decide to commit to Viking's deal-by-deal structure 2) the phase where the investors makes the decision to invest in a deal-by-deal case, and 3) the phase after the first investment have been made. In each phase, we present the information asymmetries identified to pose the biggest threat for the investors and how trust is connected to how the investors cope with these asymmetries. The deal-by-deal structure itself is static, but some of the traditional incentives and monitoring mechanisms presented in the literature are more important in some phases than in others.

6.1 COMMITTING TO VIKING

This phase is, as more closely defined in chapter 5.1, the period leading up to the investors making their first investments. The main problem in this phase seems to be an adverse selection problem related to the investors' ability to discover Viking's true abilities.

6.1.1 The adverse selection problem lies in the investors' ability to discover Viking's true abilities

Viking is more informed about their own true abilities and the quality of the service that they provide than the investors are (Eisenhardt, 1989). However, the investors are more informed about the portfolio companies in the deal-by-deal structure than they were in the traditional fund structure, giving them more of an opportunity to try distinguishing bad projects from good ones (Kandel et al., 2011). As the investor has not yet formally signed off on investing in Viking and their structure, hidden actions resulting in moral hazard are not regarded as a prominent problem for the investors in this phase.

6.1.1.1 Overall, the investors trusts Viking's abilities

Based on Viking's reputation for having experience, competence and being orderly, the investors express that they trust in Viking's ability to do the job in according to their best interests. In the process leading up to the investors orally agreeing to invest in Viking's deal-by-deal structure, Viking themselves along with information in the network, are the most important source of information concerning Viking's abilities and performance. Thus, to make the decision to commit to Viking, the investors must trust that the information Viking provides about themselves and their abilities is reliable and honest. The investors' perception of Viking's honesty is especially important as it makes the investors trust the information Viking presented when pitching the new deal-by-deal structure.

6.1.1.2 Reputation is perceived as a reliable source to information about Viking's abilities

Viking seem to be highly regarded in the investment community in Trondheim, and their reputation affects the forming of the investors' trusting beliefs in Viking, indicating that Viking is successful in signaling their higher quality (Deephouse, 2002). The reputation forms the investors' beliefs about the competence of the Viking team, thus serves as a strong signal from Viking (Lee, 2011) giving the investors a security (Wahrenburg, 2003). Viking's reputation is the most emphasized aspect of the investors' trusting belief in Viking. Furthermore, the reputation also includes information about Viking's willingness to tell the truth, even when the truth is disappointing for the investors.

Viking's reputation seems to communicate mostly calculative information, which is not surprising as relational trust is built over time when two parties conducts a number of social and economic exchanges (Rousseau et al., 1998). Furthermore, when there are no solid relational bonds, economic assessments are essential when deciding to commit. It is difficult to conclude to what degree Viking's reputation influence the investors' trust in the deal-by-deal structure itself, it is more likely that the system trust is based on the presentations where Viking details the specifics of the contracts, incentives and investment strategy. But overall, Viking's high standing in the investment community in Trondheim is important in forming the investors' trusting intention, that is, making the investors willing to later depend on Viking (McKnight & Chervany, 1996).

Viking's reputation has been an important factor in reducing the adverse selection problem, as the information in the network about Viking's experience early in the process gave the investors' expectations about Viking's behavior and abilities (Amit et al., 1998). However, although Viking have a decent track-record some of the investors were less convinced by earlier performance, as Viking had troubles with their Viking II-fund, not getting the returns they initially predicted, which according to Klein & Murphy (1988) and Lerner & Schoar (2004), should lead the investors to avoid reinvestments through the same GP. However, the investors who commented to the deal-by-deal structure were clear that the Viking team was not to blame, as there were no signs that they didn't do their best. Rather, they argue that the fund was caught by the financial crisis. Still, their performance and growth over the past years have led to their track record being a solid signal of quality. All these signals reduce the adverse selection, as they are costly to develop and, combined, signals Viking's quality. All in all, the findings indicate that trust does not reduce problems relating to adverse selection, but makes the investors willing to accept the risks involved - creating the basis for them making a leap of faith.

6.1.1.3 Investors with prior experience with Viking have developed a loyalty to Viking

The investors without prior experience with Viking primarily base their trust the structural assurance of the system and Viking's competence. Their rationale to commit is mainly concerned with potential financial returns. In contrast, the investors who have prior experience with Viking mainly focus on the relational aspects when it comes to their trust in Viking. What is apparent is that the group of investors who have invested in Viking for a long time also place an emphasis on a certain loyalty to Viking - they are not sure they would invest in a similar structure if another venture capital firm had offered them the same deal, as they express that they wish to invest in ventures that can contribute to the building of Trondheim as business city. This indicates that there is an underlying loyalty towards Viking present, which again leads to the investors deciding to commit to Viking. This is by definition trusting behavior, as the investors accept the risks related to adverse selection and choose to invest even though negative consequences are possible (e.g., Coleman, 1990; Mayer et al., 1995). Furthermore, this group of investors is more willing to act trustingly towards Viking, not relying as much on control mechanisms, and seem to be less likely to question Viking's motivations.

In summary, loyalty to Viking is for the "old" investors are an important element in their decision to invest in the deal-by-deal structure, alongside their wish to "give back" to Trondheim as a city. The motivation to give back to Trondheim is not always altruistic. One of the investors argued that it was "good for business" when the economy in Trondheim were booming. Still, for the "new" investors, the decision to commit to the deal-by-deal structure is overall more based on a financial rationale.

6.1.1.4 Some investors express a concern related to Viking's management capacity

As the findings show, two of the investors are particularly critical to Viking's ability to manage and grow all the companies they invest in, as Viking only have 6 employees. This is a concern for two of the investors which is related to their trust in Viking's honesty about their own competencies, and their abilities to do the things the investors' need to have done. This exposed an information asymmetry related to adverse selection; namely that the investors cannot verify the capacity cap of the Viking team. If Viking overestimates their own management capacity, the case companies will be affected, thus the investors will suffer. This perceived problem can be related to the investors trusting beliefs in Viking (Stein, 1971; McKnight & Chervany, 1996), as the investors express that they don't completely trust that Viking always will be acting in their best interests. The problem can also be related to the investors perception of Viking's benevolence as the investors are in doubt of whether Viking is willing to serve what they believe to be in their best interests, by expanding the team (or investing in fewer companies), thus being able to spend more time on each case.

6.1.2 The specialized focus of the business model reduces the investors' need for information about Viking's abilities

The investors argue that the industry- and phase-specific nature of Viking's deal-by-deal structure reduces the need for information on their part, as the uncertainty related to technology development is reduced (Lerner & Schoar, 2004. Viking has a clear investment strategy and only invests in companies in a growth phase with functioning technology. The fact that the investments are consequently in companies who have passed the seed phase is positive for the investors, who claim that there is a lot less risk related to both technology and information about the company as a whole in the growth phase. The problem with unproven technology in the case company is taken out of the equation.

6.1.2.1 The time frame of the investment is attractive to the investors

The investors emphasize that the outlined time frame of the investment is attractive and an important part in their decision to commit to Viking. As Viking has already found companies eligible for funding, they have effectively shown the investors that they are capable of finding good investment objects, thus reducing the problem with adverse selection related to information about Viking's abilities as compared to in the fund structure. Some of the investors argue that a short timespan allows them to stay informed over the entire lifetime of the investment, and that they might not risk getting "too old" before the investment is exited if the timeframe was to be the same as in a fund structure. The longer the investors must wait for an exit, the more skeptical they will become of the structure.

Viking needs to exit companies to have the capacity to manage new companies. Both exiting and fundraising is critical for Viking to earn their fees, as there are no longer a management carry which gives Viking the incentive to extend the lifetime of the investment. Thus, Viking can, and must, focus on building good projects, and cannot afford too many "bad" exits. Further, as a management carry can give the GP incentives to extend the fund year after year to collect annual carry (Phalippou, 2007), by implementing a fee structure consisting partly of an entry cost that covers the entire lifespan of the investment and a success fee after exit, the moral hazard related to Viking expanding the lifespan of the investments year after year to collect management fees is by the investors perceived to be eliminated. Related, with a deal-by-deal carry, there exist a potential moral hazard in that Viking might prioritize some companies more than others as venture capital firms usually do in the traditional structure where the carry is portfolio based.

6.1.3 Summary and takeaways

The focus of this phase has been the adverse selection problem relating to the investors ability to assess Viking's abilities. In many ways, by assessing mechanisms described by traditional agency theory such as performance, reputation and sector specialization, the information asymmetry between the investors and Viking is reduced in this phase. It is found is that Viking signals their abilities through their reputation, through their own personal meetings with the investors and through the decision to focus on a more specialized business model. These mechanisms are especially more important for the investors who have no prior business relationship with Viking. Viking's proven performance is an important factor for the "old"

investors, while network ties is more important for the "new" investors, as Viking has a high standing in the investment community in Trondheim. The investors in the investment community seem to discuss Viking when they meet, providing the investors without a previous business relationship with Viking information about them. The new investors mainly seem to be motivated by expectations of financial revenue, while the older investors show that they invest in Viking because of a loyalty that has developed through the years. For the investors with an ongoing relationship with Viking, the information in the network works more as a confirmation of what they already think, as they have developed a loyalty towards Viking.

Still, there is an adverse selection problem in that the new system works differently than the traditional fund structure. Specifically, some of the investors have expressed concerns related to Viking's capacity to manage and grow the companies, while at the same raising funds for new investments.

6.2 INVESTMENT DECISION

This phase is defined in chapter 5.2, and is the phase leading up to the point where the investors make the decision to invest in a case company in the deal-by-deal structure.

6.2.1 The investors rely on Viking's ability to provide relevant information about the cases

The investors identify the main risk in this phase as Viking's ability to provide them with 1) honest and 2) sufficient information about the investment cases. Viking is controlling the information flow, resulting in a potential problem with hidden information and hidden actions. An important element of Viking's deal-by-deal structure is that the investors know what they invest in, and that they could opt out if they want to. There is a consensus among the investors that this aspect of the deal-by-deal structure as a positive change from the traditional fund structure, as in the traditional fund structure the investors may know the venture firm's investment strategy, but they have no insight or ability to influence the venture firm's investments.

6.2.1.1 The investors are satisfied with the information they receive prior to investment

Most of the investors are aware of the potential risk related to Viking's ability to provide them with the right and relevant information. However, most the investors expressed that they were not concerned about Viking intentionally holding back important information, as they believe that Viking will suffer from such a breach of trust as much, or more than, the investors. However, one of the investors stated that he was not completely satisfied with the information provided by Viking. He expressed that he believed the information provided was incomplete and that it was difficult to make an informed decision based only on the presentation and the written summary. Wanting more information about each case can be an indicator that he wants more control and be able to, at least to some degree, do his own due diligence. This could further mean that his trust in the competence of the Viking-team is lower than the other investors, affecting his trusting behavior towards Viking (McKnight & Chervany, 1996).

6.2.1.2 Lack of knowledge about the sector of business lead to the investors not conducting due diligence on the cases

The findings show that none of the investors, except for one, conduct their own due diligence on the companies presented by Viking, which according to Cherib & Sraieb (2008) is critical for an LP. Some of the investors think the information is interesting in that they get to see what they invest in, but that they would invest in more or less any case Viking presents. This can be problematic as it can be a cause for an adverse selection problem. As the investors do not have the ability to verify the information provided by Viking, they are at a risk of being opportunistically exploited by Viking (Mishra et al., 1998). One investor explicitly argues that he invests in the trust he has in Viking's abilities; therefore, he is not dependent on being able to verify the industry specific information. Most of the investors recognize that there exists an adverse selection related to Viking's opportunity to withhold important information from the investors, however, they do not see it as a realistic scenario and are certain that Viking has no incentives to hide information from them, as it would only cause them damage. Furthermore, the investors argue that there exist other sources of information about the case companies that is open to the public, and that if they really wanted to, they would find the information they were looking for, implying that they rely on the network as a source of information, or in theoretical terms a control mechanism (Shane & Cable, 2002), increasing the investors feelings of security (Lewis & Weigert, 1985).

6.2.1.3 The consequences of acting opportunistic could destroy Viking's ability to raise funds

Viking has few to no long-term incentives of intentionally withholding information and going behind the investors' backs. If it were to be known that Viking were purposely withholding information from the investors, Viking would lose the trust they have spent years building in the investment community in Trondheim. Because Viking operates in a close-knit community, information is spread in virtually no time, and the investors can require private information about Viking by accessing the investment community and network with other private investors. If negative information about Viking's trustworthiness were to spread in the investment community in Trondheim, Viking's ability to raise funds in Trondheim could be lost (Kollmann et al., 2014). This is especially important in the deal-by-deal structure, as they must raise funds for each investment case, meaning they must raise funds two to four times a year.

6.2.2 The structure reduces attitudinal differences

The structure is perceived by the investors to reduce problems with asymmetric information, as it aligns the incentives of the investors and Viking through the fee structure, and through the investors' increased decision-making ability.

6.2.2.1 Increased decision making authority for the investors also increases flexibility

In the deal-by-deal structure, the investors not only *know* what companies they invest in, they can *choose* what companies to invest in. Hence, the deal-by-deal structure opens for hands on decision-making compared to a traditional structure. The investors are not bound by any written contracts to invest, or what sums to invest, in the cases presented to them. Thus, the investors can be flexible and invest with a basis in their liquidity situation. This aspect of the deal-by-deal structure is emphasized as one of the most appealing qualities of the structure by the investors. Nevertheless, if an investor skips more than two investments in a row without providing a good reason, Viking will not invite the investor back to invest. Thus, although the investors have the right to opt out, they still must make a certain number of investments to be a part of the system.

6.2.2.2 The attitudinal differences between Viking and the investors are more aligned in the deal-by-deal structure

The investors argue that the outcome based fee structure allows them to trust in Viking, because they are "in the same boat". When talking about the investment process through Viking, some of the investors did not talk about the investors and Viking as separate entities - they said *us*, referring to both themselves and Viking as one. This is interpreted as the deal-by-deal system creating a feeling of being on the same team. The reasons behind the alignment emphasized by the investors are that Viking is invested in the case companies and that they receive the major part of their compensation through successful exits. By introducing an "entry fee" covering all costs related to the investment, while also being heavier invested in the cases themselves, Viking is provided with incentives to do their job thoroughly from the start, and to do a thorough due diligence process. The first incentive is the loss Viking themselves faces on their own investment in case if the case company doesn't succeed. The second incentive is that Viking have a good reason to work efficiently with the companies receiving funding and exiting within the specified timeframe of 3-5 years. The longer the time to exit, the less financial resources Viking has to manage and grow the company. The findings show that the investors are aware of these incentives, providing them an important reason for trusting Viking with their investments.

6.2.2.3 The incentive structure is part of forming the investors' trust in Viking

Gompers & Lerner (1999) claim that LPs mainly use contracts to control problems related to moral hazard and adverse selection, but it turns out there are variations to what degree the investors emphasize the contracts and incentives. Some of the investors have carefully read the contracts and are aware of the incentives that exists, and is to some degree critical to what degree Viking will be able to fulfill all their promises. On the other hand, some of the investors' have not read the contracts when they sign - they rely on Viking's presentation of the deal-by-deal structure, which is an indicator of trusting behavior (Fox, 1974; Dobbing, 1993). Others even feel special when they get the opportunity to invest in Viking. Therefore, one could argue that while these incentives gives the investors the structural assurance they need to participate (Zucker, 1986; Shapiro, 1987), they already trust Viking and its team to such a degree that they would be willing to invest in Viking even without all of these incentives and mechanisms. Still, by transferring some of the risk from investors onto

themselves, compared to in the fund-structure, the findings show that Viking has created a system the investors are much more comfortable with.

The new fee-structure strengthens the investors' trusting intention. Especially two of the five dimensions are affected by the system trust: potential negative consequences and feelings of security. As the new system, compared to the traditional fund structure, transfers some of the risk from the investors over to Viking, the potential negative consequences are in effect lessened. Furthermore, in the new model the investors' feelings of security are strengthened (Lewis & Weigert 1985; Bradach & Eccles, 1989; Eayrs, 1993; McKnight & Chervany, 1996). This was apparent during the interviews as the investors often compared the new model with the old one, often describing the latter in negative terms.

The incentives and contracts that regulate the fee-structure are influential in forming the investors' trust. As these elements are not personal but related to the deal-by-deal structure itself they mainly influence the investors' system trust (McKnight & Chervany, 1996). Still, one cannot exclude the possibility that Viking's willingness to make a substantial change from the fund-structure might also influence the investors' trusting beliefs in Viking's team. The mechanisms described in this chapter give the investors structural assurance, as it works as safeguards against opportunistic behavior (Zucker, 1986; Shapiro, 1987; McKnight & Chervany, 1996). Several the investors' mentions these structures as important reasons for participating in Viking's deal-by-deal structure. System trust is, in many ways a calculative form of trust - one believes that structures are in place to secure the preferable outcome (Rousseau et al., 1998).

6.2.3 Summary and takeaways

The analysis of this phase has focused on Viking's ability to provide the investors with the correct information, and the investors' ability to maintain information about Viking and the case companies, from both Viking and other sources. The analysis shows that the trust, and the type of trust, that exists between the investors and Viking, leads to the investors accepting the risks related to adverse selection. The analysis show that the investors mainly trust that Viking provides them with correct and relevant information, as the investors are not interested in conducting their own due diligence on the case companies due to time restrictions and the small sums the investments represent. The access to information seem to be more important

and assuring than the information itself, as the investors' liquidity is found to be, at least among the "new" investors, the most important factor when they are deciding whether to invest or not.

One can argue that the trust related to the problems with asymmetric information in this phase is mainly built on calculative trust. On one hand, the investors get to make their own assessments and get more insight, and therefore more control over the process. The information they receive is a way of monitoring Viking's actions. The investors base some of their trust on what Viking could lose if they were to get caught acting opportunistic. However, trust is rarely either calculative or relational, but have elements of both (McKnight & Chervany, 1996). On the other hand, there are lots of relational elements involved. One element of the investors trusting intention is their feelings of security. For those who have invested in them earlier it seems almost unthinkable that Viking would be dishonest. This trusting intention is based on years of experience with Viking and during that time they have not experienced Viking not providing the correct information. Therefore, there is little suspiciousness towards Viking. Still, the investors mainly focus on the structural assurance of the system itself when they describe why they trust Viking to provide the correct information, and further argue that the fee structure is designed to align the incentives of the two parties. Therefore, overall, the trust in this phase seems to be more calculative than relational.

6.3 Follow up

The follow up phase is the final phase in the analysis, and it is the phase after the decision to invest in a case company has been made. The focus of the analysis will be on the investors' need for information to follow up their investments in the case companies. In the previous phases, they have signaled their abilities and experience to the investors, and in this phase, Viking must prove to the investors that the information about their quality provided through the signals are accurate.

6.3.1 The access to information is more important than the information's utility

In general, the investors trust the information provided to them by Viking without second guessing it. This indicates that it is the access to information itself that is important, not information's utility. The findings show that the investors overall think it is nice to be

provided with information from Viking, but that they don't have the competence to do in-depth analysis of the industry specific information related to the case. However, the investors explain that the information provided gives them a feeling of security, indicating that the information asymmetry is perceived to be reduced when compared to the previous fund structure. This can be related to the fundamental trusting beliefs that investors have in Viking in the deal-by-deal structure. They trust in Viking's ability to screen and chose the most promising companies. This can be understood as an indicator of the investors' trust in Viking's competence (Stein, 1971).

Although the investors receive more information in the deal-by-deal structure than in the fund structure, Viking still controls the main portion of information that the investors receive about the case companies. Most of them think it is interesting to follow the companies, but one of the investors, except for one, do in depth analysis of the quarterly reports. This means that the investors both trust that the information they receive is correct and that they trust Viking's ability to grow these companies. To the investors, it is unthinkable that Viking would intended provide incorrect - or even hide - information (Eckermann, 2006), which is an indicator of their trust in Viking's honesty (Bromiley & Cummings, 1995).

However, there are practical reasons for the investors not to do their own analysis on top of the work Viking have done: they have limited time and that the capital they invest in Viking only is often only a small portion of their total fortune. This means that the capital they potentially lose when investing in Viking, is capital they are willing to risk. Lastly, one of the investors points out that the trust he has in Viking makes him less critical to their actions, and that he believes they will always to their best, making another analysis obsolete. The investors not following up on the information provided by Viking can be related to a lack of reliance of control. Lack of reliance of control is an important part of trusting intention (McKnight & Chervany, 1996). One could argue that the flow of information in the new system is a control mechanism, where the investors can use the information to second-guess Viking's assessments. However, it is an essential part of the system itself and the fact that the investors, apart from one, accept the information they receive without doing much of their own analysis is a form of trusting behavior (Dobbing, 1993). Furthermore, as the investors now have insight into the companies Viking invests in, they are more aware of the potential negative consequences (McKnight & Chervany, 1996). This again strengthens their feelings of security in their trust in Viking (ibid) and informs their trusting behavior towards Viking.

6.3.2 The investors learn more about Viking's abilities over time

The investors express that they have learnt more about Viking's abilities over time, and especially by being invested in them (Lerner & Schoar, 1994). However, signaling is also an effective mechanism, and in Viking's case, especially signaling in the form of reputation and experience. Viking have had a successful exit in the deal-by-deal structure, and has uncovered what they are capable of to the investors involved. Viking's reputation has also grown and improved over time, which gives the investors a reason for trusting in them. Some of the investors reflected over their relationship with Viking, and argued that their trust in Viking has become stronger than in the two previous phases, as they now have direct interaction with someone from the Viking-team regularly. All the investors emphasize their perception of the competence and honesty of the Viking team. Over time, their interaction with Viking also has become more predictable. This is an important trait relating to the trusting beliefs dimension (McKnight & Chervany, 1996). In the context of the potential moral hazard related to Viking prioritizing some investors over others, the system itself do not provide structure assurance. This means that in this context, the investors rely heavily on their trusting beliefs in the Viking-team.

6.3.3 The investment community serves as a source of information about the progression of the case companies

As with other potential pitfalls related to their relationship with Viking throughout the phases, the investors use the investor network in Trondheim to gather information about Viking and the progress of the investments. As the information flow in the investment community in Trondheim is high, the investors believe it would be easy for them to discover a) any wrongdoings on Vikings part and b) hidden information about the cases. As "everyone involved knows everyone" invested in Viking, the investors rely on trusting in each other as well as Viking. Also in this phase, the reasoning limited time and small investment sums makes the investors refrain from actively following up on the case companies after investment.

6.3.4 There exists a concern with Viking prioritizing some investors over others among some investors

Some of the investors pointed out that one important aspect of the structure is that everyone is equal, and everyone gets the same opportunity to invest. The investors were adamant that it would be an obvious breach of trust if Viking gave some of the investors better investment terms, more information about the cases, or that the best investment cases only were presented to a chosen pool of investors. This issue is to the investors representing both a reversed adverse selection problem for the investors where they must signal their worth to Viking, and a moral hazard problem related to hidden actions on Viking's behalf. For those mentioning this potential problem it seemed to be a matter of principle not to be treated any differently than others.

As there are currently no mechanisms resolving this problem, the investors who express their concern rely heavily on their trust in, and relationship with, Viking. Although some of the other investors were aware of this potential moral hazard, they did not believe Viking were to start prioritizing some investors over others without letting them know, and if it was to happen, the investor community in Trondheim would let them know immediately. However, as the potential negative consequences are smaller than with other moral hazards, the investors' trusting intention is not necessarily affected to a large degree. But, the investors are still taking a risk in trusting in Viking in this case. For the two investors worried about this issue, their feelings of security are consequently reduced (McKnight & Chervany, 1996). The fact that they continue to invest, without demanding contracts making sure Viking cannot differentiate between the investors is a clear display of trusting behavior, as they do not monitor or control Viking's behavior, and that they are willing to place their resources in Viking (Fox, 1974; Shapiro, 1987; Dobbing, 1994; Coleman, 1990). The trust described can be said to be more relational than calculative as the investors believe in Viking's benevolence - they do not believe Viking would act opportunistic.

6.3.5 Summary and takeaways

Viking is still in charge of the flow of information about how the case companies are developing, resulting in a possibility for Viking to hide information about the cases. There is also identified a potential moral hazard problem for the investors through a concern of Viking prioritizing some investors over other investors without letting them know, as the promise to

participate in every investment is for the investors not regulated by a contract. This is also perceived as a reversed adverse selection problem, where the investors are worried that they must signal to Viking that they belong in the "elite" group of investors. There is really no satisfactory mechanism to secure Viking not differentiating between the investors in Trondheim and investors located in other geographical areas

The investors learn more about Viking's abilities over time, both by being invested in the deal-by-deal structure and by being a part of the investor community. Limited time and small sums lead to the investors further following up the companies they are invested in other than reading through the quarterly reports from Viking. Overall, in this phase, the investors' trust in Viking seems to be leaning in a more relational direction than in the previous phases. It is no coincidence that Viking are willing to provide more favorable terms for the investors, as they are now is a position where they need to raise funds for each investment. Viking need to trust that the investors provide capital when they are to make an investment. If the conditions are favorable then the chances of the investors not wanting to invest is reduced. From this perspective, one could argue that the new system not only strengthens the investors' trust in Viking, it also strengthens Viking's trust in the investors. Another issue related to the growing investor pool is a situation where there are too many investors, and where the investors are not allowed to invest enough capital for the investment to make sense for them.

6.4 ACROSS THE PHASES

The research question in this thesis is *how is trust connected to how investors cope with the perceived information asymmetries in a deal-by-deal structure?* By using the framework presented in Chapter 2, the authors have analyzed how trust plays a part in coping with the information asymmetries in each phase, when traditional mechanisms as monitoring and control is suboptimal. In this subchapter, we will present findings related to the investors coping with information asymmetries that are relevant across all the phases.

6.4.1 The deal-by-deal structure itself increases trust over time

When it comes to the adverse selection problem related to the commitment and follow up-phase, there exists some structural mechanisms that over time gives the investors insight into Vikings ability to produce returns. These mechanisms in themselves are facilitating the

building of trust more than it would over time in a traditional fund structure. The reason for this is that the deal-by-deal structure facilitates a more open and honest flow of information. When Viking present the case companies, the investors get insight into which assessments Viking have made regarding the companies they have decided to invest in. As Viking now provide the investors with information ex-ante, the investors are given the opportunity to ask questions and make the investment decisions themselves. This is essential in building trust (Das & Teng, 1998). This means that the investors meet the MP and some of the other team members of Viking at least two to four times a year. Communication provides the basis for continued interaction (Leifer & Mills, 1996). A side effect of these meetings is the building of relational trust between the parties. Over time, the trusting belief regarding the other party's predictability forms (McKnight & Chervany, 1996). Furthermore, the fact that the investors now have access to more information than earlier is an important part of the investors' system trust that again is connected to reducing perceived information asymmetries between Viking and their investors.

6.4.2 Trust is becoming more relational over time

There is reason to believe that this system will contribute to the continuous building of relational trust over time. First, the parties communicate face-to-face a lot more than earlier (Leifer & Mills, 1996). Second, predictability in the relationship forms (McKnight & Chervany, 1996), and third, where the investors in the traditional fund structure transferred all their decision-making to Viking; they are now part of the process. Some of the investors even express that they are partly accountable if investments go sour, as they were the one who chose to invest.

Trust plays different, but important roles in how the investors cope with information asymmetries throughout all the phases presented in the last subchapters. The longer they stay invested in Viking, the more the investors' trust in Viking seem to develop towards a relational trust. However, in the analysis it is found that the investors' previous relationship with Viking is an important factor to determinate of where on the relational/calculative-dimension the investor is. The investors who invested in Viking's traditional fund structure seem to lean more in the direction of relational trust than the newer investors throughout all the phases. In the first and second phase, the trust between the new investors and Viking seem to be mainly calculative, while it is moving more and more towards a relational trust as the

final phase, and their relationship with Viking develops. The investors with stronger ties to Viking seem to have developed a stronger relationship with Viking, and is in general exhibiting a more trusting behavior towards Viking.

However, although the investors' trust in Viking is strengthened over time, the investors do not accept blatant breaches of trust. It takes time to build trust, but it is easily destroyed. Cvetkovich et al. (2002) research showed that negative information has a stronger effect on decreasing trust that positive information had on increasing it.

6.4.3 Withholding information is the most important source for losing trust in Viking

The investors had different ideas of what would lead to them losing their trust in Viking, but there is a consensus among the investors that the most important source for them losing their trust in Viking is withheld information. The other categories related to losing trust are related to returns and differentiation. In general, the investors said that they accepted bad investments but that it was critical for them to receive the correct information they needed. For some investors, the trust is based on the output of Viking's investments. The investors in this group all stated that bad investments happen and they accept that risk. But if Viking were consistently making bad investments, then they would lose trust. Both the size of the returns and how long they would have to wait were things that the investor's thought was crucial for their trust in Viking. Although the investors expressed that trust to some degree can be easily lost, they were also confidant that Viking would not do something that would make them lose their trust. For most of the investors it seems unthinkable that Viking would do anything that would make them lose their trust. For some of the investors the trust in Viking is so high, and it seems so unlikely that Viking will do anything that destroys their trust, that they do not bother to read the contracts between them and Viking.

6.5 SUMMARY OF THE ANALYSIS

The main finding regarding the research question is that although the deal-by-deal structure facilitate a better flow of information than in the traditional fund structure, perceived information asymmetries still exists. Contractual covenants are used by both parties to control each other's behavior in certain situations, however contracts are not enough to explain the way the behavior between the parties is regulated. Furthermore, the investors are not

contractually bound to continue to invest in each project and can stop investing in Viking altogether if they do not find the business relationship satisfying. It is here trust plays a crucial part. Trust does not reduce information asymmetries; it makes the investors accept the risks related to asymmetric information, which might lead to problems with adverse selection and moral hazard. Thus, the investors can be said to be making a leap of faith. Most of the investors find it almost impossible to think Viking would do anything to breach the trust that has been built. In many ways, trust is the lubricant that facilitates continued action in the business relationship, with incentives and contracts working as structural assurance for both parties.

However, the investors rely on trust to different degrees and in different ways. For some, trust is in and of itself a mechanism keeping Viking from acting opportunistic. They argue that information about Viking doing something that was not in their best interest would be shared in the investment community. This would make it difficult for Viking to continue the deal-by-deal structure, as trustworthiness is a valued trait the investors are looking for in business partners (Kollmann et al., 2014). This view of trust is calculative as it is viewed as a mechanism that stops Viking from acting opportunistic. It is found that some of the investors rely more on calculative trust than relational trust. Those who rely on calculative trust are also mainly those with the shortest business relationship with Viking - the investors who first started investing after Viking changed to the deal-by-deal structure (Rousseau et al., 1998). Their arguments for trusting Viking are often based in a trust of the system itself. The mechanisms that exists to reduce moral hazards and adverse selection provides the basis for their trust. Furthermore, when they describe their trusting beliefs in Viking, they mainly focus on their competence. It could be argued that competence is a calculative trait, as Viking's competence is the trait that will give them returns later. In general, this group seemed more concerned with potential moral hazards and adverse selection problems. This could indicate that their relationship to Viking, at the moment of the interviews being carried out, was not very robust. But, as will be discussed later, it is found that the deal-by-deal system is structured in a way that, over time, allows more relational trust to emerge.

Generally, an investor invests to make a profit and therefore zero-sum evaluations are always to some degree the basis of a business relationship. That means that some degree of calculative trust always is present. But it is also found that some of the investors, especially those who invested in Viking's traditional fund structure, feel some sort of loyalty to Viking.

Although aware of potential moral hazards and adverse selection issues, they were generally less concerned than those with less experience with Viking. Furthermore, they often argued that venture capital investments are inherently risky, and they would therefore accept a bad investment from time to time. Instead of viewing a bad investment as Viking not doing their job, as those with a less experience with Viking were more likely to do, they would focus more on external factors such as market trends. This is an indicator that they ascribe good intentions on the part of Viking (Williams, 1993), which is typical for relational trust. This could be a sign that their relationship to Viking is more robust, than those having more calculative trust.

However, the introduction of a new system demands that the investors trust in both Viking and the system - not to reduce the adverse selection problem related to Viking's true abilities, the problem will remain in the relationship until Viking show that they can exit the companies - but for the investors to be willing to accept the underlying risk that exists before entering the structure.

7. DISCUSSION

The research question for this thesis is *how is trust connected to how investors cope with the perceived information asymmetries in a deal-by-deal structure?* In the analysis, several challenges related to adverse selection and moral hazard were identified. Furthermore, mechanisms reducing these problems were analyzed in the light of trust. The main conclusion of the analysis is that some of the incentives in Viking's deal-by-deal structure reduce some of the information asymmetries, but that risks of opportunistic behavior continue to exist. Trust is the mechanism that makes the investors accept the risks involved. In this chapter, findings from the analysis will be discussed in the light of literature. The chapter is structured in two parts. First, trust is discussed in the context of perceived information asymmetries in the deal-by-deal system. Second, the analysis showed that the investment community plays an important role in the deal-by-deal structure. In part two the authors discuss the antecedents of trust that was discovered in the analysis, but not included in the original framework. The framework is then modified to include social ties as an antecedent of trust.

7.1 TRUST IN THE DEAL-BY-DEAL STRUCTURE

The findings in the analysis are in line with the arguments of researchers arguing that a pure economic perspective on reducing agency problems through contracting is undersocialized (Granovetter, 1985). In this subchapter, the authors discuss how the deal-by-deal structure itself allows trust to emerge, and how trust works as additional form of protection by allowing more frequent contact between Viking and their investors (Kollman et al., 2014).

7.1.1 The deal-by-deal system itself allows relational trust to emerge

It is expected that trust, over time, emerge in a business relationship, as certain expectations starts to form to each other behavior (Axelrod, 1984). But, in contrast to in the traditional fund structure, it is found that the deal-by-deal structure itself encourages the parties to trust each other rather than engage in heavy contracting and monitoring. Sitkin & Roth (1993) argues that contracting can be detrimental to trust. Furthermore, the system itself facilitates the parties behaving in ways that are trust building. This indicates that trust is connected to asymmetric information in a deal-by-deal structure through not only the personal characteristics of the people involved, but also the structure itself.

7.1.1.1 The correct incentives are in place

Viking's structure offer more investor-friendly covenants and allows the investor greater control of his or her own funds by giving them the ability to decide what projects to include in their portfolio on a deal-by-deal basis (Jesch, 2010), and by aligning the incentives of Viking and the investors. It was found that although the investors trust Viking's intentions to varying degrees, they all felt that the incentives and contracts in place gave them the structural assurance needed to trust Viking. The two incentives that was most often mentioned were that Viking themselves invests in the companies, and that the management fee is a one-time investment for each company. The first incentive gave the investors the feeling of being in "the same boat" as Viking. The second incentive solves a problem most of the investors have with the traditional fund structure - that Viking has nothing to win by extending an investment, if it's not increasing the returns for the investors. As a result, although investors do have access to more information than they had in the traditional fund structure, it seems that they rarely thoroughly analyze the information they get - they accept it at face value. Thus, by aligning the incentives between the investors and Viking the structure facilitates trusting beliefs from the investors' side, as it increases the system's predictability and controllability, providing the investors with an additional mechanism for coping with information asymmetries.

7.1.1.2 The parties communicate more frequently

Drawing from the analysis, the authors argue that trust is not only more encouraged in the deal-by-deal structure, the system itself is building trust by allowing the parties to communicate more frequently. A traditional fund structure assumes that the investors make an investment, and seven to twelve years later they get the returns (Tarrade, 2012). There may be some interaction with the fund's manager, and periodically updates on the state of the fund, but overall the fund is a black box. The deal-by-deal system is a continuous process where the investors and Viking meet regularly, where the investors get to ask critical questions and where they themselves gets to make the decision whether to invest or not. Thus, the structure forces the parties to communicate more often and more information to be shared between the parties. All in all, Viking's deal-by-deal structure facilitates continued interaction over a longer period than in the fund structure, and although the timeframe of each investment is shorter, more robust relationships built on trust and loyalty can emerge (Rousseau et al., 1998). This is an important aspect of the deal-by-deal structure as over time certain

expectation of behavior starts to form (Lane & Backmann, 1998). In the beginning, the structural elements can be the basis for the investors making the leap of faith, but over time more relational trust is formed, allowing less costly transactions between the parties.

7.1.1.3 The transition from a fund structure to a deal-by-deal structure is an example of Viking being willing to adapt to the investors' needs

It is important to note that Viking's change to the deal-by-deal structure was not only fueled by the possibility of higher earnings, it was a response to investors not seeing the fund structure as an attractive investment form. Making adaptations according to the trustor's needs and being willing to invest the time dimension needed is understood as trusting behavior (Murakami & Rohlen, 1992; Das & Teng, 1998). It is an important finding that Viking have an active trust building strategy with the new system, as they see trust as a valuable and extremely important asset. Viking regards information flow and communication as an important part of this strategy, which, as discussed in the analysis, the deal-by-deal structure facilitates. Furthermore, they show a willingness to communicate over a range of issues (Webb, 1991). As Leifer & Mills (1998) argue, communication is an important part of building trust because it provides the basis for continued interaction. Viking's strategy also includes managing the investors' expectations. This means not giving clear goals with high expectations but rather give ambiguous goals with low expectations (Butler & Gill, 1997). Providing the investors with bigger returns that first projected strengthens the investors' trust in Viking's abilities in general.

7.1.2 The deal-by-deal structure makes Viking more vulnerable

The analysis revealed that the deal-by-deal system itself comes with certain challenges for Viking. First, the system demands more from Viking than the previous fund structure as they must share more information and have more frequent contact with the investors. Second, in the fund structure Viking could focus, at least in part, on one thing at the time. In the beginning they focused on fundraising, before doing the due diligence on the case companies. After investments were made, they could focus on managing the companies, before making an exit (Tarrade, 2012). In the deal-by-deal system, they must do all these things at same time, while also having to continuously maintain their relationship with the investors, which could create strains on Viking's capacity. Third, the fee structure in the fund structure provided Viking with a stable income over 7-12 years, and the investors could only really evaluate

Viking after the fund was closed and the returns were distributed among the investors. Now, the investors get regular updates on each company and as the first exits are made, within 3 to 5 years, the investors can choose not to continue to invest, resulting in a risk for Viking to find themselves in what Lerner & Schoar (2004) refer to as the illiquidity puzzle. Furthermore, in the fund structure contracts secured that the investors provided the capital they had committed to. Now, the investors can choose to opt out on certain cases, meaning Viking could find themselves in situations where they cannot provide the capital to the company as promised. Fourth, Viking, at least in the beginning, mainly recruited investors from the investment community in Trondheim. Having investors from one only community poses two potential risks for Viking. First, most of the investors have invested the largest part of their capital into the real estate marked, meaning a crash in this market could cause a lack of liquidity on their part, which could lead to them opting out of investing due to their liquidity situation (Lerner & Schoar, 2004). Second, as the investment community in Trondheim is small, information flows easily as they share information among each other. If rumors, true or false, about Viking being untrustworthy was to surface, Viking could, again, find themselves in a situation where the investors would stop investing, however, as the analysis show, the investors interviewed has no concerns that this will happen as long as Viking exhibits trustworthy behavior.

Most of these challenges do not have clear solutions; they are a part of the system itself. However, Viking express that they have a strategy to avoid being in a situation where they do not get the capital they need to invest. They have started to expand their investment pool to other communities, mainly from Oslo. By doing this, they get access to more capital and lessens the chances to be in a situation where they cannot provide the capital they have promised to the companies. Furthermore, there is a high flow of information in local investment communities, but not necessarily between one investment community to another. Therefore, the risks of negative rumors, true or false, spreading between all the investors are reduced. However, there are challenges related to expanding the investor pool. The first one is practical as they now have more investors to deal with. Viking prefers meeting the investors face to face, which takes more time, as Viking is located in Trondheim. Second, when the investor pool is expanded there are more investors willing to invest, which potentially could mean smaller investments per investor. This might be a problem for some of the investors who want to invest larger sums. One investor pointed out that it was not interesting to only invest small sums of money. Another potential challenge is related to the relationship between

Viking and the investors from other geographical areas than Trondheim. Viking had a good reputation in Trondheim, was well known in the area, and had strong relationships with several of the investors. This created the basis for the relational trust that has started to emerge. As Viking do not have the same relations to investors from other areas, it is likely this trust is more calculative. This kind of trust is more likely to be oriented around financial returns, and will pressure Viking to perform, and, furthermore, is more volatile than relational trust, and Viking must derive more of their motivation to perform well by the threat of termination of investments (Klein & Murphy, 1988).

7.2 SOCIAL TIES

Social network ties are present throughout all the phases the analysis, but is not a part of the original framework presented in the end of chapter 2, as the focus of the thesis has been on how trust is connected to asymmetric information in a deal-by-deal structure. However, it is found that social ties are an antecedent for trust to exist, thus it must be discussed.

Social network ties are explained in chapter 2.2.3.4. Both direct and indirect social ties are used to get information one otherwise would not have access to (Shane & Cable, 2002). Most of the investors in the investment community have direct ties to each other, although the strength of the ties varies as some view each other as friends while others are viewed more as business acquaintances. Half of the investors interviewed were invested in one or more of Viking's funds. These investors had direct ties to Viking before the deal-by-deal structure was introduced, meaning they had an existing relationship. The investors with no prior relationship with Viking before entering the deal-by-deal structure can be said to have had indirect ties with Viking before committing to the deal-by-deal structure. Today, all the investors who has committed to the deal-by-deal structure have developed direct ties to Viking, but it is found that those who have been with Viking since the funds have stronger ties to Viking than the other half.

The relationships in the investment community have proven critical for the trust the investors have in Viking. The analysis showed that trust is an essential part of the relationship between the Viking and the investors, regulating both parties' behavior. Although the investors sign a contract each time they invest in a case, the investors are not contractually obligated to invest in each case, resulting in the fact that large portions of the relationship between Viking and

the investors is not regulated by contracts. However, another finding is that the social ties that exists in the investment community plays an important role in both reducing information asymmetries and building trust between the investors and Viking. The social ties themselves could work as a mechanism keeping opportunistic behavior on Viking's part in check. This is discussed in the next three subchapters. Lastly, based on this discussion the authors propose a modification to the framework used in the analysis, incorporating social ties.

7.2.1 Social ties as an antecedent of trust

Social ties seem to play an important part in the investors' trusting beliefs in Viking, and one can argue that these indirect and direct ties is an antecedent for trust to exist between the parties. Whether an investor already has developed a direct social tie or not with Viking seems to affect the degree of trust the investor had in Viking when committing to its deal-by-deal structure. Some of the investors have developed direct ties with Viking through previous business transactions, which have provided them information about Viking's trustworthiness, affecting their trusting beliefs. Furthermore, for those who only committing to Viking after deal-by-deal structure was implemented, indirect social ties to Viking, provided them information about Viking's trustworthiness. Hence, these social ties lay the foundation for the investors' development trusting beliefs in Viking (McKnight & Chervany, 1996). As the investors share their honest opinions with each other about Viking's performance, an expectation of Viking acting trustworthy arises. This is in line with Granovetter (1973), who show that social relationships within communities facilitate information flow and knowledge flow between the individuals in that community.

The general perception among the investors is that Viking have a high standing in the investment community in Trondheim. Naturally, the social ties precede the trusting beliefs construct and the system trust construct because people base their perceptions of others on the information they have. In summary, for those without direct social ties with Viking the information conveyed by those with direct ties constitutes the basis for their perception of Viking. For those with direct social ties with Viking, the information they get from the investment community serves as a supplement to the information they already have. As a result, those with direct ties with Viking have a more relational trust in Viking, than those without those ties in the pre-commitment phase.

7.2.2 Social ties help the investors cope with the asymmetric information

Understanding how social structures surrounding the economic transaction plays an important role in how the investors cope with information asymmetries in Viking's deal-by-deal structure.

7.2.2.1 Social ties provide the investors with private information about Viking

Before the investors commit to Viking, the social ties in the community provide the investors with information about Viking's abilities that they otherwise would not have access to. The investors who had no previous business relationship with Viking had all heard of Viking through their network, and some even had met members of the Viking-team in several social settings. According to Lerner & Schoar (2004), the best way of obtaining information about the quality of a fund is by being invested, as only then one can access private information about the quality of the service. However, both those with and those without prior experience with Viking emphasized the importance of the information they gathered through people in the investment community in Trondheim through both direct and indirect ties. For Viking, it was important signal to their abilities to the investment community by establishing a solid reputation. An important finding in the analysis was that the investors with previous business experience conveyed Viking's reputation and their track record with Viking prior to the deal-by-deal structure to the rest of the investment community. By being previously directly involved with Viking those investors had better access to information about the quality and competence of Viking (Cherif & Sraieb, 2008). This information was then discussed internally in the investment community. Hence, the network of investors in Trondheim together became a screening device as many people processed the information about Viking (Burt, 1992). Viking was, through their direct ties, to some of the investors able to signal their abilities to the rest of the investment community in Trondheim. This is in line with Burt (1997) who finds that social ties allow people who do not have direct ties to obtain more information than they could obtain on their own.

7.2.2.2 The strength of the social ties forms the trust between Viking and their investors

Viking almost have a monopoly on the information about the investment cases in the second phase, and one could argue that the form of trust that exists between the investors and Viking, in this case relational or calculative, is determined by the strength of the social ties that exists. This refers to the fact that social ties inform the investors' decision to believe the information

presented by Viking is trustworthy (McKnight & Chervany, 1996). As seen in the analysis, most investors believe in the information they were presented with without conducting any due diligence on their own. Another interesting finding was that most of the investors who had direct social ties before committing to Viking's deal-by-deal structure make the decision to invest within just a few hours of the presentation, mostly without talking to other investors. Those who did not have direct social ties to Viking before committing, more often talked to other investors before making the decision to invest. Mostly, no new information about the cases are introduced when they discuss the case, but they exchange their thoughts on the case and point out key elements, which means that they together screen the cases (Burt, 1992). But, more importantly, the social ties work more as a reassuring mechanism. If one investor hears that another investor he respects has invested, they feel more secure in their own decision to invest, resulting in a feeling of security, enabling the investors to make a leap of faith.

The investors also use their social ties in the investment network in Trondheim to discuss the progress of the companies they have invested in. As discussed in the previous paragraph, they base these discussions on the information given to them by Viking and rarely do their own due diligence. As some of the investors are more competent at analyzing the information provided by Viking, they can be used to enlighten other investors of the development of the companies. Hence, through their direct ties with each other, they try to gain a better understanding of the companies' progression. However, as the follow up phase is continuous, over time, the social ties to Viking grows stronger, and the investors seem to be less dependent on using other investors to interpret information given to them by Viking. As a result, some of the investors do not contact others in the network, they rather ask Viking directly if they have any questions.

7.2.2.3 Social ties work a control mechanism, increasing feelings of security

Most of the investors rely on their social ties as source of information and an additional control mechanism. If they have any concerns regarding Viking that they don't want to address directly with Viking, they can talk to each other to clear things up, reducing their dependency on Viking and effectively reducing the need for trust in Viking (McKnight & Chervany, 1996). However, this mechanism can also be said to increase the investors' feelings of security, as they feel more assured about laying their faith in Viking as others in the network do the same. If Viking were to act in a way that is against the investors' best

interest, this information would easily spread through the investment community. Thus, in practical terms, these social ties work as a control mechanism for the investors, as they are "watching out for each other". An interesting aspect of this is that both parties are aware of this mechanism. Some of the investors even argue that opportunistic behavior easily would be discovered and that information would in no time be transferred to the rest of the investment community. This means that the social ties that exists in the investment community not only hypothetically would work as a control mechanism if Viking makes an undesirable action, the ties themselves becomes a security that the investors base their trust on.

7.2.3 Modifying the framework

In the previous chapter, the importance of social ties in relation to trust have been discussed, and found to be especially important. By trusting in Viking, the investors have found a way of coping with information asymmetries, where monitoring and control is found only to be ineffective. This is especially interesting regarding the framework developed in chapter 2. A deficiency with the current framework is that it does not include an analytical dimension to analyze *where* trust comes from, and *how* it emerges.

Social network theory has traditionally incorporated trust as a part of direct social ties, not an antecedent to trust. For example, Uzzi (1996) argues that direct ties are characterized by the parties wanting to act trusting and fair towards each other, and without direct social ties, zero-sum business transactions are more likely to occur. The authors find that social ties, at least in the context of this thesis, is an antecedent of trust. Instead of seeing indirect ties as lacking trust, as Uzzi (1996) argues, the authors argue that indirect ties are defined by more calculative trust, while direct ties are defined by more relational trust. Furthermore, one can differentiate between strong ties and weak ties (Granovetter, 1973). One finding in this thesis is that all the investors now have direct ties to Viking, but those who invested in Viking's funds before committing to the deal-by-deal structure is more trusting towards Viking. This indicates that weak direct ties are defined by more calculative trust, while strong direct ties are defined by more relational trust. This means that the strength of the social ties gives an indication on the robustness of the relationship.

Thus, the authors argue that the theories on trust, agency theory and social ties provides a way for understanding trust as a tool for coping with the perceived information asymmetries in a deal-by-deal structure, as trust between the parties reduce the need for costly monitoring and

contracting (Becerra & Gupta, 1999; Ferris et al., 2017). By adding direct and indirect social ties to the framework, researchers are better equipped to analyze *where* trust comes from and the *robustness* of the trust. Thus, the authors propose a modification to the framework presented in chapter 2 where direct and indirect social ties, as understood by Shane & Cable (2002) and Granovetter (1973), is added. The new framework is illustrated in Figure 5.

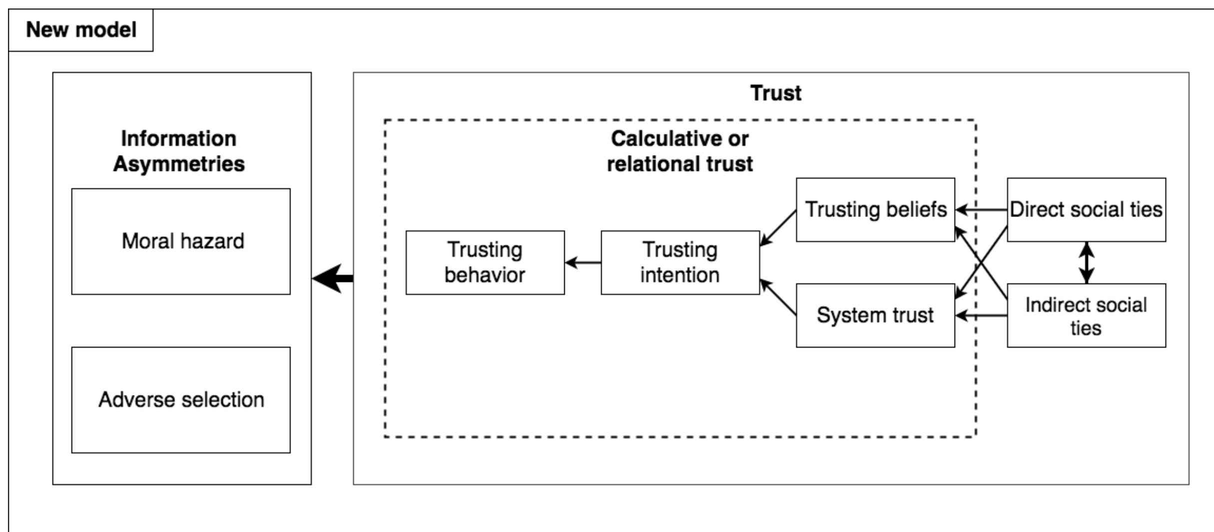

Figure 5: The Modified Framework

8. CONCLUSION

The authors of this master thesis have explored how trust is connected to asymmetric information in a deal-by-deal structure. More specifically, the authors have tried to answer the research question *how is trust connected to how the investors cope with the perceived information asymmetries in a deal-by-deal structure?*

It is found that trust is connected to how the investors cope with information asymmetries in a deal-by-deal structure in the way that it leads the investors to accept the risks that is intrinsic to the relationship and the structure when the risks cannot be controlled by traditional mechanisms such as contracts and monitoring. Trust, and particularly system trust, further serves as an additional assurance when risk is regulated by contracts.

The investors believe that the deal-by-deal structure is more effective than the fund structure in providing Viking with incentives that aligns the interest of Viking and investors, effectively reducing the problem with asymmetric information that might result in moral hazard or adverse selection problems. However, the analysis show that even though the correct incentives and mechanisms is in place, it is perceived by the investors that the deal-by-deal structure does not completely eliminate the possibility for opportunistic behavior on Viking's side, as it is not possible to regulate all moral hazards and adverse selection problems through contractual covenants. Still, the contractual covenants in Viking's deal-by-deal structure has proved important in determining the system's predictability and controllability, as the fee structure in particular gives Viking the incentives to develop and sell the companies to receive returns, resulting in a strong structural assurance.

It can be argued that the deal-by-deal structure facilitates trust in the way that it is more transparent and flexible for the investor than a fund structure, as it provides the investors with more decision-making authority. Furthermore, the system itself facilitates regular interaction between the parties, a better flow of information, and as the business relationship now is continual and possibly could last decades, stronger relationships are built, resulting in a more relational trust than in a fund structure. Expectations are built between the parties, relieving some of the transaction costs that are present at the beginning. This also shifts the trust from calculative to relational, as the investors need to rely less on structural assurances. In the long

run, this could be problematic as trust can lead to underestimation of the other party's willingness to act opportunistic if the situation is right (Nooteboom, 1996).

How the investors cope with the asymmetric information is also closely related to their trust in Viking's experience and reputation, and how information related to this is transferred through in the network through social network ties. The reputation travels in the closed knit network that is the investment community in Trondheim. Viking's, and especially the MP's, experience seems to be of importance, as the experience they have built up over the years and how they have handled both success and downfalls makes the investors more inclined to depend on Viking and provides them a feeling of security (McKnight & Chervany, 1996). Viking's reputation is based on their track record (which is related to their experience), the personal traits of the investment team, and their trustworthiness, resulting in a high standing in the investment community in Trondheim. Thus, trust in the network and their conveyance of Viking's reputation is heavily connected to how the investors cope with information asymmetries in the deal-by-deal structure.

The strength of the network ties seems to be a determinant for the strength of the trust. By including the dimensions of calculative and relational trust, the authors have examined the robustness of the trust that lies in the relationship between the investors and Viking. Trust is built over time and generally develops between actors involved in an exchange relationship. Still, one important finding is that the deal-by-deal structure facilitates a business relationship that over time can evolve from a predominantly calculative trust to a more relational one. In conclusion, trust is connected to how the investors cope with asymmetric information in Viking's deal-by-deal structure by enabling them to accept the risks that are intrinsic both to the relationship with Viking and the structure, enabling them to make a leap of faith.

9. IMPLICATIONS AND FURTHER RESEARCH

This study has focused on a socialized take on a phenomenon that is hard to explain by using traditional agency theory alone. Regarding the theoretical implications, only a minority of the articles on relationships in the venture capital industry combine agency theory and trust theory. Even more rarely do these articles combine these theories when analyzing the relationship between LPs and GPs. The agency relationship between the LPs and the GPs has received a lot less attention than the agency relationship between the entrepreneur, and through the work with this thesis, it is found that there is a need to shed further light on this relationship, as many remains questions unaddressed (Phalippou, 2007). Additionally, as the deal-by-deal structure is a fairly new concept, there exist only a few papers on the topic. Those papers mainly theorize how such a system could be organized and what the benefits might be. As a result, there is not a lot of material to compare the findings of this thesis with.

Still, this paper contributes to the literature on venture capital in several ways. Important information asymmetries in the new structure have been identified. The paper has shown what incentives exist in the deal-by-deal structure to mitigate risks related to these information asymmetries, and how these incentives affects the investors' perception Viking's possibilities to act opportunistic. Furthermore, the master thesis has presented a complex analysis of the trust that exists in the GP-LP relationship, and shown how trust leads to the investors accepting risks. The authors have shown how calculative and relational trust can lead to different degrees of robustness in the relationship. Lastly, social network ties were found to be an important antecedent for trust to arise between the investors and Viking in this particular deal-by-deal structure.

Some of the findings of this thesis have practical implications. Kollmann et al. (2014) found that trust plays an important role in the traditional fundraising process. Venture capital firms inherently makes risky investments, although the degree of risk varies. If a venture capital fund manages to raise a traditional fund, their incentive to build trust with the investors is that it makes the next fundraising process easier. This could have the result that the investors trust in the venture capital firm is mainly calculative - their trust is based on predicted returns and if those are not met it is easy not to invest the next time the venture capital fund is seeking investments. The deal-by-deal structure, on the other hand, requires the venture capital firm to raise funds for each company they want to invest in. At the same time, they must be able to

create exits. This means that the investors, after some time, have the ability to evaluate the venture capital firm's performance while investing. As calculative trust is less robust than relational trust. If the trust the investors have in the venture capital firm is predominantly calculative, one or more bad investment on the venture capital firm's part could lead to the investors stopping to invest. One practical implication therefore is that the venture capital firms who implement the deal-by-deal structure are more dependent on building relational trust with the investors.

Furthermore, GPs looking to implement a deal-by-deal structure should consider that strong social ties should be in place the structure to be successful. This remark is particularly important if the GP is young and has yet to build a solid reputation, and have not developed the right channels to signal their abilities (Gompers & Lerner, 1999). The investors in researched in this thesis are embedded in a network in a concentrated geographic area. This thesis show that kind of standing the GP has in the network can be critical for their abilities to raise funds on a deal-by-deal basis. Furthermore, venture capital firms with no social ties, or only weak ones, to the region might have a hard time raising funds in the network, as trust is a process based phenomena where credibility built on occupational history, good references by mutually known contracts and the prospect of future exchange is important (Nohria, 1992; Cvetkovich et al., 2002). This is an indication of the fact that if a venture capital firm wishes to copy Viking's model, to recruit investors they must establish a decent reputation and trust in the network, and the network should be placed in a defined geographical area to allow face to face information flows between the investors. This can imply that the structure Viking has chosen is not for everyone. In sum, structurally, the model can be duplicated, but the venture capital firm should have established strong direct ties, defined by relational trust, to some or all the investors in one or more investor communities.

For further studies on the research area, the authors have a few suggestions. We recommend conducting a quantitative study to explore how venture capital firms who have implemented the deal-by-deal structure are performing. Although Viking has been successful, this might not be the case for other venture capital firms. Related, as this study has focused on a case company that already had a high standing in the investment community, it should be interesting to explore what the conditions should be present for a deal-by-deal structure to be successful, and how important the levels of trust in a certain community affects the venture capital firm's ability to get investors to commit.

Another interesting topic for further research could be to explore how a deal-by-deal structure affects the companies and entrepreneurs receiving investments. In contrast to the traditional fund structure, the deal-by-deal model means that the venture capital firm does not have a pool with money they can use "freely". They must raise funds for each case. This could lead to a situation it becomes more important for the venture capital funds to reach exits as early as possible, to signal their abilities to the investors and build trust, rather than pursuing a long-term strategy.

Additionally, the authors suggest more extensive studies on the research area of deal-by-deal structures in venture capital in general, as there is a severe lack of research of the phenomenon. As the limited partnerships receive criticism it is important to research other models where the fundraising and investment process are more investor friendly. Lastly, more studies on how to build the necessary trust to be able to raise funding in a deal by deal both in and outside a close-knit community should be conducted.

10. LIMITATIONS

By choosing to investigate a single case, the findings are not possible to generalize, but provides deeper insight into a specific case in a specific context. This has affected the transferability of the findings in this thesis.

Ideally, the investors should have been interviewed more than once over a longer time frame to be able to be more specific about how trust develops over time, but due to the study's limited time frame this was not possible. By asking the investors to talk about what happened in the past and what they think might happen in the future, the answers might not be as honest and correct as they would have been if they had been interviewed at the time of the event, as one tends to rationalize actions afterwards.

Viking might have been biased in which investors the authors were put in contact with. This might have led to Viking connecting the authors with investors who were "Viking-friendly", instead of investors who have voiced their critical opinions about Viking, which could have affected the results in the thesis.

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