Entrepreneurial experiences from venture capital funding: exploring two-sided information asymmetry

Citation for the original published paper (version of record):
Glücksman, S. (2020). Entrepreneurial experiences from venture capital funding: exploring two-sided information
asymmetry. Venture Capital, 22(4): 331-354. http://dx.doi.org/10.1080/13691066.2020.1827502

(article starts on next page)

VENTURE CAPITAL
https://doi.org/10.1080/13691066.2020.1827502

Routledge
Taylor & Francis Group

OPEN ACCESS Check for updates

Entrepreneurial experiences from venture capital funding: exploring two-sided information asymmetry

Sarah Glücksman

Department of Technology Management and Economics, Division of Entrepreneurship & Strategy, Chalmers University of Technology, Gothenburg, Sweden

ABSTRACT

Information between entrepreneurs and venture capitalists (VCs) is often shared unequally. VCs are experienced and professional dealmakers, while entrepreneurs have great knowledge about their venture but usually limited knowledge about VCs' financing process and requirements. For entrepreneurs, VCs' asymmetric information advantage can lead to difficulties in receiving funding, unfavorable terms, or negative startup experiences. Based on in-depth interviews with 20 Swedish entrepreneurs, this study investigates entrepreneurial experiences of mitigating the problems arising from information asymmetry in a VC–entrepreneur relationship. Four themes emerged from these interviews: (1) choosing the optimal time to raise the initial external capital, (2) ensuring that the VC fits the startup, (3) studying and understanding the venture capital process beforehand, and (4) building an open and honest relationship with the VC. Although entrepreneurs have not developed any formal tools similar to what VCs employ to mitigate information asymmetry risks, our study shows that entrepreneurs use informal tools based on their own and others' experiences. This indicates that the entrepreneur might play a more active role in the VC–entrepreneur relationship than most previous studies have assumed.

ARTICLE HISTORY

Received 27 February 2020
Accepted 18 September 2020

KEY WORDS

Venture capital; information asymmetry; agency theory; adverse selection; moral hazard; entrepreneurial perspective

1. Introduction

> Fundraising doesn't always mean success. Congratulating an entrepreneur on raising money is like congratulating a chef on buying vegetables.
>
> Ankur Singla, founder of Akosha.com

Venture capitalists (VCs) invest equity capital in entrepreneurial ventures, where they search for ventures with a potential for rapid growth that can achieve significant size and market position (Gompers and Lerner 2004). A major problem in the VC–entrepreneur financing situation is the presence of information asymmetries between entrepreneurs and capital providers (Amit, Brander, and Zott, 1998; Landström 2017). Information is often shared unequally among the parties and available market information about new

CONTACT Sarah Glücksman sarah.glucksman@chalmers.se Department of Technology Management and Economics, Division of Entrepreneurship & Strategy, Chalmers University of Technology, Vera Sandbergs Alle 8, SE-412 96 Gothenburg, Sweden

ventures is usually very limited. Some of the issues that arise from information asymmetries are agency problems, which generally arise in the form of adverse selection and moral hazard (Amit et al. 1998). Numerous researchers have studied the mechanisms that VCs have developed to mitigate their agency problems, such as screening, contracting, monitoring, and staging of investments (e.g., Arcot 2014; Burchardt et al. 2016; Cumming 2006; Fried and Hisrich 1994; Gompers and Lerner 2004).

However, the information asymmetry in the VC–entrepreneur relationship is two-sided in the sense that new entrepreneurs usually have limited knowledge about the VC's decision process and investment cycle (Dessein 2005; Landström 2017). VCs are experienced and professional dealmakers, while entrepreneurs have great knowledge about their venture but usually limited knowledge about VCs' financing process and requirements. This can lead to disadvantages for the entrepreneurs in terms of difficulties in receiving funding, receiving unfavorable terms, or having negative startup experiences. As the process is recurrent for VCs but infrequent for entrepreneurs, it is difficult for entrepreneurs to develop common practices or tools to manage VCs' asymmetric information advantage. Instead, new founders need to rely on the experience and knowledge of other entrepreneurs with prior venture capital experience.

Although scholars have acknowledged that problems arising from asymmetric information are two-sided (Carpentier and Suret 2006; Christensen, Wuebker, and Wüstenhagen 2009; De Bettignies and Brander 2007; Drover, Wood, and Fassin 2014; Fairchild 2011; Shepherd and Zacharakis 2001), research has not managed to empirically identify how these problems are managed by the entrepreneurs. There are certain studies that take the entrepreneur's perspective on the VC–entrepreneur relationship; however, these are largely restricted to criteria entrepreneurs utilize in their evaluations of potential VCs (Bengtsson and Wang 2010; Drover, Wood, and Fassin 2014; Fairchild 2011; Hallen and Eisenhardt 2012; Hsu 2004; Valliere and Peterson 2007). What is missing, however, is research that considers how entrepreneurs manage VCs' asymmetric information advantage throughout the full venture capital cycle, from the initial selection phase, through the investment process to the exit.

This study aims to address this research gap by studying how entrepreneurs mitigate problems from information asymmetry in a VC–entrepreneur relationship. The term venture capitalist (VC) refers, in this paper, to an investor that acts as an intermediary between financial institutions and unquoted ventures (Gompers and Lerner 2001). Based on in-depth interviews with 20 Swedish entrepreneurs, this study investigates experiences gained by founders from mitigating information asymmetry problems for a VC-backed startup. Four mechanisms emerged from this process: (1) choosing the optimal time to raise the initial external capital (timing), (2) ensuring that a VC fits the startup (matching), (3) studying and understanding the venture capital process beforehand (preparing), and (4) building an open and trusting relationship with the VC (trust-building).

This study provides three contributions. First, it underlines how a two-sided agency perspective on a VC–entrepreneur relationship helps identifying mechanisms that mitigate information asymmetry problems for the entrepreneurs. Findings from this study challenge the traditional agency theory approach in a VC–entrepreneur relationship where it is generally assumed that VCs act as principals and entrepreneurs act as agents (cf. Arthurs and Busenitz 2003; Drover, Wood, and Fassin 2014). Second, it extends the existing literature on two-sided information asymmetry in a VC–entrepreneur financing situation (Carpentier and Suret 2006; Christensen, Wuebker, and Wüstenhagen 2009; De Bettignies and Brander 2007; Drover, Wood, and Fassin 2014; Fairchild 2011; Shepherd and Zacharakis 2001) by discussing the mechanisms that entrepreneurs use to mitigate the VCs' asymmetric information advantage. In so doing, this study answers calls for research on what entrepreneurs can do to create a good partnership with VCs (Zacharakis, Erikson, and George 2010) and how information asymmetries could be used to study double-sided agency problems in a VC–entrepreneur relationship (Fairchild 2011). Third, this study makes important practical contribution to entrepreneurs and practitioners aiming to support nascent entrepreneurs by gathering valuable advice on issues concerning venture capital funding.

2. Information asymmetry in the VC–entrepreneur relationship

2.1. Information asymmetry and agency problems

Information asymmetry is a condition in which one party in a relationship has more or better information than the other party (Akerlof 1970). In a VC–entrepreneurial financing situation, information is often shared unequally among the parties and the problem of information asymmetry is generally cited as the main explanation of the financial constraints faced by small firms (Landström 2017; MacIntosh 1994; Sahlman 1990; Wilson, Wright, and Kacer 2018). Among the issues that arise from information asymmetries are agency problems (Jensen and Meckling 1976). These problems arise because of "hidden information" and "hidden actions" between the parties (Amit et al. 1998). Hidden information refers to a situation in which one party possesses relevant information that is not known by the other party, for example, entrepreneurs have more information about their driving forces and their venture than investors. A situation with high information asymmetry in the form of hidden information creates the risk of "adverse selection" where the VC will have difficulties distinguishing between good and bad ventures to invest in. Hidden actions tend to give rise to "moral hazard," which occurs when one party cannot observe relevant actions taken by the other party, for example, once the entrepreneurs have raised capital, they might spend it on items that are not in accordance with the VC's interest.

However, the problem of information asymmetry is two-sided in the sense that nascent entrepreneurs are unfamiliar with VCs' financing process and requirements and that VCs sometimes withhold certain information from the entrepreneurs (Carpentier and Suret 2006; Landström 2017). Difficulties in distinguishing between good and bad VCs due to lack of experience and knowledge is an adverse selection problem for the entrepreneur. The choice between different funding alternatives (e.g., bank lending, business angels, VC, bootstrapping) can also result in an adverse selection problem for the entrepreneur due to a lack of knowledge and experience about the advantages and disadvantages of different types of startup funding.

Furthermore, a VC often provides substantial managerial contributions to the venture (Gorman and Sahlman 1989; Gompers and Lerner 2004; Hellmann and Puri 2000). However, these "efforts" provided by the VC are not something that can be verified beforehand, creating a potential moral hazard problem for the entrepreneur in which the VC might expend insufficient effort (De Bettignies and Brander 2007). The fact that a VC often has a portfolio of firms means that an investor's risk profile differs greatly from an entrepreneur's; because the VC's investments are more diversified (Manigart, Baeyens, and Van Hyfte 2002), the investor might push the entrepreneur toward excessive risk-taking. In addition, VCs need to allocate their limited resources between all their portfolio firms. Hence, actual allocation of resources might differ greatly from those which an entrepreneur's requirements and expectations (Gifford 1997). There is also a time limit to the relationship. VCs need to realize their investments after a certain number of years to show returns to their investors, which might push the VC to exit early. The intended and actual post-investment behavior of the VC could, therefore, be perceived as entailing both hidden information and actions hidden from the entrepreneur.

Several researchers have started to argue that the agency perspective in entrepreneurial finance literature describes the VC–entrepreneur relationship in a one-sided direction. These scholars argue that most research on moral hazard is focused on the VC's control over the entrepreneur's opportunistic behavior while ignoring the entrepreneur's concern that the VC may act opportunistically (Christensen, Wuebker, and Wüstenhagen 2009; Drover, Wood, and Fassin 2014; Shepherd and Zacharakis 2001). Hence, prior works conclude that adverse selection and moral hazard problems are present from the VC's perspective as well as from the entrepreneur's perspective.

2.2. Mitigating information asymmetry risks

The ability to manage information asymmetry risks tends to distinguish good capital providers from the bad ones (Amit et al. 1998). Numerous researchers have studied the mechanisms that VCs have developed to mitigate their agency problems (Drover et al. 2017). To overcome adverse selection problems, investors use mechanisms such as screening, due diligence, syndication of deals, and specialization (e.g., Cumming 2006; Fried and Hisrich 1994; Gompers and Lerner 2004). To overcome moral hazard issues, VCs use mechanisms such as staging of investments, legal contracting, and extensive monitoring (e.g., Arcot 2014; Burchardt et al. 2016; Pruthi, Wright, and Lockett 2003). Entrepreneurs use mechanisms as "signaling" to reduce uncertainty and information asymmetries which concern VCs. In order to convince capital providers about the qualities of the venture, entrepreneurs need to send positive signals about themselves and about their venture. Examples of such signals are the establishment of a limited company, relating the venture to individuals and businesses with higher status or educational experience of the management team (Connelly et al. 2011; Bollazzi, Risalvato, and Venezia 2019). The term "investment readiness" is used together with signaling to explain whether founders are perceived to possess the attributes, which makes them an investible proposition by an investor (Gregory et al. 2012; Silver, Berggren, and Veghohn 2010).

However, all the mechanisms above are used to reduce the information asymmetry risks from the *VC's perspective*. The goal of these mechanisms is to make it easier for VC's to distinguish between good and bad ventures (adverse selection) or to decrease the risk of opportunistic behavior from the entrepreneur (moral hazard). To the best of our knowledge, no study has so far examined how entrepreneurs mitigate *their* information asymmetry problems. How do entrepreneurs distinguish between different funding alternatives and investors (adverse selection) or how do entrepreneurs handle their concern that the VC may act opportunistically (moral hazard)? Therefore, the purpose of this study is to investigate how entrepreneurs mitigate information asymmetry risks in a VC–entrepreneur relationship.

2.3. Entrepreneurial perspective on the VC process

Although there is a vast literature about how VCs screen and select the entrepreneurial firms they wish to invest in (e.g., Fried and Hisrich 1994; Hsu et al. 2014; Sahlman 1990), only a handful of studies have looked at VC investments from an entrepreneur's perspective (De Bettignies and Brander 2007: De Clercq et al. 2006; Drover, Wood, and Fassin 2014; Fairchild 2011; Hallen and Eisenhardt 2012; Hsu 2004; Valliere and Peterson 2007; Zacharakis, Erikson, and George 2010).

De Bettignies and Brander (2007) examined the entrepreneur's choice between bank finance and venture capital and found that there is a two-sided moral hazard problem when choosing venture capital as both the entrepreneur and VC provide unverifiable effort. Fairchild (2011) analyzed the entrepreneur's choice between VC and angel financing and found that an entrepreneur may consider both economic and behavioral factors when making choice of financier. De Clercq et al. (2006) discussed how entrepreneurs should find the right investors, secure the right amount of money, and obtain a deal structured in an equitable manner. The study also suggested that foundations for a good match between VC and entrepreneur relate to complementary skills and the potential for the entrepreneur and VC to have an open, trusting relationship. Although these studies acknowledge the active part of the entrepreneur in the VC–entrepreneur relationship, they have no empirical findings from entrepreneurs but base their findings indirectly on research of VCs.

Studies with empirical findings from entrepreneurs largely focus on the evaluation of potential VCs. Valliere and Peterson (2007) found that both novice and experienced entrepreneurs considered valuation to be the primary criterion, and also viewed the terms and conditions of the investment deal as important. Furthermore, the study suggested that entrepreneurs were not particularly looking for "smart money," that is, investors capable of providing a range of additional services to help the portfolio firm. Hsu (2004) suggested that entrepreneurs are willing to forego offers with higher valuations to partner with more reputable VCs. Hallen and Eisenhardt (2012) found that firms that form investment ties efficiently avoid drawn-out and high-effort searches, failed attempts, and undesirable partners. Drover, Wood, and Fassin (2014) found that ethical reputation of a VC profoundly influences the entrepreneur's willingness to partner. Zacharakis, Erikson, and George (2010) suggested that it is important for the entrepreneurial team to build cohesion both within the team and with the VC to avoid lower overall performance if conflicts arise. These studies are insightful because they suggest that the entrepreneur plays an active part in the relationship and that there are interesting insights from entrepreneurs with prior venture capital experience.

3. Methods

To investigate experiences from mitigating information asymmetry risks in a VC–entrepreneur relationship, interviews with 20 entrepreneurs who had founded one or more venture capital backed startups were conducted. To obtain interviewees, purposeful sampling was used in this study to select entrepreneurs who had experience with our research phenomenon but had various backgrounds and whose ventures were in different industries and stages. In this sampling procedure, the selection criterion is based on a specific variable of interest, often for comparison purposes (Eisenhardt 1989). The founders were found through Internet searches, personal networks, and snowball sampling of participant entrepreneurs. We included entrepreneurs who were currently funded by venture capital, as well as entrepreneurs who had received funding five to ten years ago and either they and/or the VCs had left the company. This was done to limit the influence of biases in our study, as interviews with entrepreneurs who raised funding some time ago could potentially contain retrospective bias and entrepreneurs with current venture capital financing could be considered hypothetical in nature. Thus, our approach balances both prospective and retrospective experiences. Most of the founders had experience of at least one failed attempt at raising venture capital.

Table 1 lists the descriptive information for all interviewed entrepreneurs and their companies. The startups were founded between 1997 and 2015. Two companies had been liquidated by founders, three companies had been acquired, and four companies had made IPOs. The remaining companies were still run as privately held firms. The number of employees based on the last available annual report varied from 3 to 71, with a median number of 13 employees. The entrepreneurs were either still working in the venture capital funded startup, had started a new company or had become an angel investor (individuals who invest their own capital in new startups). If the founder was no longer with the company, this was noted as an "entrepreneurial exit" in Table 1. An entrepreneurial exit refers to founders of privately held firms who leave the firm they started and thereby reduce or loose ownership and decision-making power in the firm (DeTienne 2010). Certain entrepreneurs had founded several ventures and were noted as

Table 1. Table of interview participants.

Primary industry	Company founded	Entrepreneurial exit	Position today	Age	Serial entrepreneur
Media Tech	2008	No	CEO	33	No
Business Intelligence	2009	No	CEO	40	Yes
Health Tech	2014	No	CEO	34	No
Software/Services	2011	Yes	CEO new company	37	Yes
Sales and marketing platform	2012	Yes	Angel investor	39	Yes
Consumer products	2004	Yes	CEO new company	55	Yes
P2P distribution network	2015	Yes	Employed	31	No
Renewable energy	2007	Yes	Consultant	39	Yes
Energy monitoring	2008	No	Business Developer	37	No
Medical equipment	2004	Yes	CEO new company	38	Yes
Video analytics software	2006	Yes	CEO new company	39	No
Medical equipment	2005	No	Board member	60	No
Recruitment	1997	Yes	Founder new company	51	Yes
Computer graphics	2002	Yes	Consultant	45	Yes
Online gaming	2004	Yes	Investor	39	Yes
Green Tech	2010	No	CEO	34	No
HR Tech	2014	No	CEO	39	No
Gamification	2012	No	CEO	37	No
IoT	2013	No	Business Developer	30	No
Tech components	2014	No	CEO	59	No

"serial entrepreneurs" in Table 1. For these entrepreneurs, the interview was based on the experiences from the first startup for which they had received venture capital. The questions regarding the subsequent ventures focused on what they did differently compared with the first venture. Although this study focused on institutional VCs, that is, limited partnerships where the partners invest in the VC fund, most ventures were financed with external capital from both institutional venture capital and business angels. Two out of the 20 interviewed entrepreneurs were women.

To gain additional perspective and triangulate the data from the entrepreneurs, two additional interviews were carried out with VCs who previously had founded their own venture capital-backed startups. The interviews with these investors mainly focused on how they use their entrepreneurial experiences in discussions with new ventures today. In total, 22 interviews were conducted. Additionally, current and archival secondary data for each founder regarding their venture capital funding were collected, including website materials, annual reports, and newspaper clippings. These documents added details to the background story and allowed comparisons with the interview data.

A semi-structured format was used for the interviews, starting with a standard list of questions (Appendix A). We talked about their financing journey and for each phase in the venture capital cycle, from initial selection phase, through the investment process to the exit, we asked what they had learned and what advice they would give someone else in a similar situation. We also discussed what they would do differently if they were to raise venture capital again for a new venture. The interviews were structured to obtain insights and experiences from all phases of the venture capital cycle. After 10 to 12 interviews, we started to see evidence of saturation, with respondents giving very similar answers to our questions. On average, interviews lasted approximately one hour. Once completed, the interviews were transcribed and analyzed using Nvivo software. We began coding inductively, using first-order codes based on concepts and themes expressed directly in the statements of the interviewees (Corbin and Strauss 2014; Van Maanen 1979). Codes and themes were reviewed and adjusted until agreement among researchers was achieved. Figure 1 shows the progression from the first-order coding to second-level themes (Gioia, Corley, and Hamilton 2013), which then produce our aggregate understanding of how entrepreneurs mitigate the information asymmetry problems in a VC–entrepreneur relationship.

4. Results

4.1. Choosing the time to raise the first external capital (Timing)

The first mechanism that emerged from our analysis was the timing for raising the initial external capital. Choosing the right time and considering the need behind raising external capital mitigates the risk of adverse selection by helping entrepreneurs distinguishing between venture capital and other financing sources. Our interviews suggested that founders need to understand advantages and disadvantages of using different funding sources at different points in time. Several of the interviewees stressed that founders should not raise venture capital too early unless they really have to. By bootstrapping and applying for public grants or loans, many startups can often decrease the need for

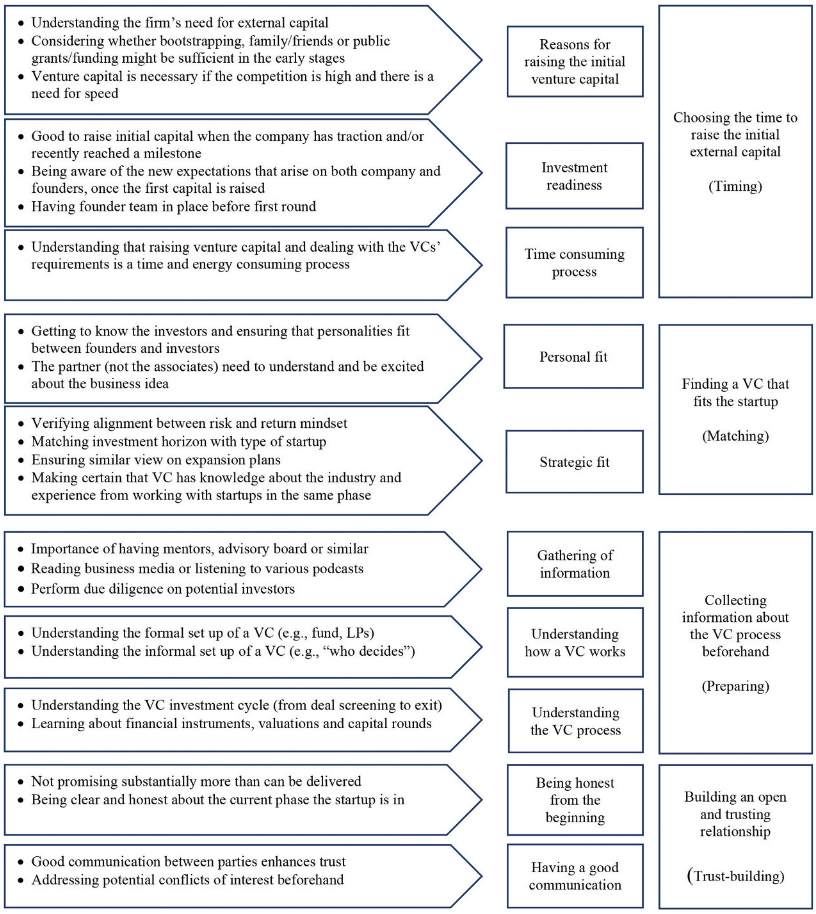

Figure 1. Overview of data structure.

external capital in the very early phases. Venture capital is necessary if the competition is high and there is a need for speed to get to market. As one entrepreneur explained:

> If new entrepreneurs asked me about advice on raising VC, I would ask them if they really needed the money right now and if there was any way they could lower their burn rate instead. In most cases you can wait longer than you think.

In research, the term "investment readiness" is used to explain whether founders are perceived to possess the attributes that make them an investible proposition by an investor. Our study suggests that this term is equally important from the entrepreneur's perspective. The founder and the startup need to be investment-ready before they receive external funding. Many interviewees stated that founders need to be prepared for the new expectations that arise from the moment the first external capital is raised. As one entrepreneur said:

> As soon as you raise external capital for the first time it is like you turn an hourglass. No matter how good and patient investors you have, the clock starts ticking. Not only in your investors' mind but in the minds of other people and other investors.

Suddenly, there is a benchmark on how far the company needs to have gotten after a certain time, for example, in terms of level of revenue and conversion rate. Consequently, it is often good to raise capital when the startup already has gotten some traction or when a milestone has been reached.

> My first and most important advice is to never be in a hurry to raise venture capital. If you start to raise VC the first thing you do, you will be in a very bad position to negotiate, which means that you will get bad terms and then you really need to work to get your investment and to prove that your idea works. If you wait and take it at a slower pace, get 1-2 paying customers, get some angels who invest, then when you approach the VC firms you will not need to work as hard, instead they will be interested to come to you since you have something that seems to work since you have paying customers. It is then about raising money to grow, not finishing the development of your product. That is really what venture capital should be for.
>
> I believe that many startups could just take an extra year to do things right, and not rush into venture capital which many experts tell you to. VC has its place. But it works best when you have something that is up and running but you need to grow faster to not lose out on growth opportunities.

Some entrepreneurs even mentioned the possibility of raising capital when the startup is not in need of external capital. In this way, they have a better negotiating position against capital providers. Almost all interviewed founders had started with some form of external capital from business angels. Funding from VCs came in the second to fourth round. The entrepreneurs quite frequently mentioned that raising capital is a time-consuming process. The founder needs to be aware that from the moment the first external capital is raised a lot of time and energy need to be devoted to reporting and working with requirements from current investors and recurring capital rounds.

> It takes a lot more time to work with these things than you think. In the end we had one person working full time with these kinds of questions. Not the same person, but someone was always occupied with either reporting requirements or new prospects. So, it comes with a cost.

Another insight we found in regard to timing was the importance of having the founder team in place before the first external capital is raised. If the founder wants to have co-owners this should be settled before the VCs take their equity shares. As one entrepreneur explained:

> Even if I really wanted the first key employees to become co-owners of the company, it was too late after I had raised the first external capital. No 27-year-old could afford to buy shares based on that valuation.

Connected to this, several entrepreneurs mentioned how important it is that there is alignment about vision among founders before raising and talking to VCs. It is important that co-founders know each other well and that they know how they work together. Table 2 provides additional examples of how entrepreneurs use timing as a mechanism to mitigate information asymmetry risks.

4.2. *Ensuring that the VC fits the startup (Matching)*

The second mechanism that emerged from our analysis was the matching between VC and startup. By finding a VC that fits the startup well, the entrepreneur mitigates both the

Table 2. Choosing the time to raise the initial external capital (Timing).

Reasons for raising the initial VC	Investment readiness	Time consuming process
The right timing for external capital depends on what type of capital you aim for. I'm currently in the board for another company and we talk a lot about this; either we go for well-known or extremely experienced BA or a VC who will increase the status of the company, or we take it slowly and start with governmental loans or funding before we search for more funding.	One negative aspect [from the funding] that we didn't expect was the hype around us. Even though we were in an extremely early phase, business media wrote "Here is the tech investors' new favorite." That was good for our motivation and confidence, but it put a lot of pressure on us.	We had two different VCs with two different CFOs who each had their own templates who wanted monthly reports. Every month I had to provide them with income statement, balance sheet, financing plan. I had to update these and adapt them into two different formats. This took at least 2–3 working days a month. Then we can add all the board meetings and other stuff on top of that.
Since we were quite unknown in the industry, we quickly realized that we needed to find a way to build creditability around us as founders and around the company we wanted to build.	It depends on your ambition and the risk you are willing to take. This needs to be discussed among founders before you discuss financing strategy.	One surprise was how much they [the VCs] required reporting wise and how little they actually knew about our business.
The only reason for raising VC at an early stage is when your competition is so high that you need to move quickly. In all other cases there are usually better alternatives than venture capital.	I would also recommend new entrepreneurs to be meticulous with board meeting protocols and other documentation. People will want to look at this. And do it in English.	These guys are high maintenance.
I think that if you can solve your financing through family and friends or savings before you have a working beta version, you stand much stronger and you don't need to get diluted at an early stage.	We started to discuss with potential investors already when we still had our full time jobs. Then several of the potential investors expressed their concern about how much we really wanted to do this if we still had our full time jobs and did not risk anything.	When I now work as a private investor I always tell the founder: "Think about this before you say yes. Are you really sure that you want to have us in your company? We are extremely difficult to work with, we will be in touch almost every second day." So they don't get disappointed and think that we are crazy when we call them in the evening or on Sundays. At least then we have been open about it.
We had to raise money to get a breathing hole. To be able to employ more developers and staff as well as to work on the customers that were on their way in.	It will really help if you have something to show. It could be a really lousy prototype, but to just be able to show something will make investors think "ah this actually works."	

risk of adverse selection and moral hazard. Few Swedish startups have the luxury of choosing the investor they want. However, in our interviews many startups had at least two investors to choose between at some point during their entrepreneurial journey. Our interviews suggested that founders should consider how the VC fits on a strategic as well as on a personal level. As one entrepreneur who had the option to choose between several investors mentioned:

> We were naive in a lot of aspects, but when choosing investors, we were quite aware of the negative consequences that could arise if we got an investor who didn't have the same view as we had on of how to build a company.

Many entrepreneurs stated how important the personal fit is and compared the VC–entrepreneur relationship to a marriage. The founders will be closely connected to the people investing in the company for a long time and if the right partner was not chosen, these years can be difficult. The importance of a good relationship with the responsible partner was often mentioned by the entrepreneurs. This person should understand the company and show excitement about the business idea. As one entrepreneur commented:

> At first you might celebrate and be super happy that you managed to raise external capital, but if you haven't ensured a good personal fit with the investors, your working climate might be everything but nice. After a couple of weeks you might think 'OMG what did we get ourselves into'.

Even though the personal fit is important, the cultural and strategic fit were even more discussed among the entrepreneurs; particularly, how the risk versus return mindset needs to be aligned between investors and founders. As one entrepreneur explained:

> Our VC's investment philosophy was all or nothing, just like us founders. Our startup was an experiment and we all agreed that we should see if the experiment worked as quickly as possible.

Another area that needs to be aligned between the VC and founders is how, where and how fast the startup should expand. If founders consider growing slowly on the Scandinavian market, they should not seek capital from investors who are focusing on rapid global expansion for their portfolio companies. Furthermore, several interviewees mentioned that it is important to understand during which phase the VC usually invests in their ventures. If the VCs are used to invest in later stages, they may not be able to support a startup in a very early phase in the right way, and vice versa.

> Every startup has its phases and you need to work differently in each phase. We didn't know that our first VC usually invested in larger startups compared to us. We were in need of getting processes and structure in place but since they usually invested in companies that already had that, they instead told us to focus exclusively on growth. In hindsight, this was not a good advice during this phase.

As mentioned in the findings about the "timing" mechanism, it is preferable if the startup already has traction or has reached a milestone when raising external capital, but this in not feasible for many companies. For example, deep technology startups or medtech startups have a much longer time to market and heavy investments need to be done during the initial years. Hence, the investor match for these kinds of companies is different from companies that are easily scalable in an early phase. The classical VC with an investment horizon of three to seven years before exit is therefore not a suitable fit. Instead, these companies often turn to business angel syndicates, evergreen funds, or governmental VCs to find investors that consider the long-term investment commitment. Only at a later stage is venture capital funding a viable option for these companies. One founder of a deeptech startup explained:

> One of our investors was a VC based on a fund with limited partners. They were really good, but their money had a time limit. When they understood that they would not be able to collect their returns before the closure of the fund, they left the company.

Although the strategic fit is important, it can be difficult to receive the necessary information about the VCs to be able to assess if there is a potential fit or not. One option is to ask the VC directly. As one serial entrepreneur commented:

> In most dating situations it would be absurd to ask about the intention of the possible relationship the first time you meet. But during an investment meeting you can take the opportunity to ask the VCs about their work "If you invest in us, how do you work? How long will you sit?" and so on.

However, most interviewees suggested gathering information about the VC from earlier or existing portfolio firms instead. Our findings suggest that this information is quite easily accessible since most entrepreneurs in our study seem to be willing to help one another with these types of questions. As another serial entrepreneur explained:

> For my second startup I contacted the CEOs of the investors' current portfolio firms. I asked them how things had worked between them and the investor, what worked well and what worked less well. Then I received very valuable information. Like a job interview, you check the references.

Our interviews suggested that entrepreneurs need to do a due diligence to understand how they match with the potential VC and if the VC is going to add value in addition to capital. Finally, it should be noted that "matching" is not necessarily a question of choice in this relationship. Even when the entrepreneur has only one possible VC willing to invest, it is still important for them to investigate this single investor, so as to have reasonable expectations. Table 3 highlights the importance of both a personal and company fit.

4.3. Studying and understanding the venture capital process beforehand (Preparation)

The third mechanism related to mitigating the information asymmetry problems that emerged from our analysis was the knowledge gathering about the venture capital process beforehand. Our interviewees described how the access to information has improved notably during the last 10 years. All entrepreneurs understood that they had to do research about how venture capital functions before raising external capital. For some of the interviewed entrepreneurs the reading up on capital markets and venture capital came as a fun and interesting exercise, whereas others struggled and had little interest in these kinds of questions:

> I was extremely uninterested of the capital market and venture capital. I only wanted to build a good company. This probably caused a poor understanding of the mechanisms behind VC funding and what investors were expecting of me.

The entrepreneurs quite frequently stated the need for understanding how a VC is formally set up with a fund, limited partners, and fund managers, but also the phases of the VC fund from raising the fund to closing the fund.

> I think you need to meet a couple of investors and understand how their business model works. The model of VC investors is based on investments in a portfolio of firms. Most of these firms, 90%, will not work. That perspective is extremely important for an entrepreneur to have.

Although interviews suggested that it was important to understand how a VC formally works, the importance of understanding how the VC works informally was equally discussed. As one entrepreneur elaborated:

Table 3. Finding a VC that fits the startup (Matching).

Personal fit	Company fit
I would say that all business is about people. Who do you have on the other side? Do we have the same values? Do we want the same thing for the company? You are often not that many owners, so to create a nice and constructive working climate you need to know what everyone wants with the company.	Choose a VC that fit your company like a glove. Where the VC likes what you do and where the partner understands and cares about what you do.
If I would decide to go for VC financing again, I would probably spend more time with the people before. If the personal chemistry doesn't work, I would probably, if I could afford, back out. When we met our investors, it was always 100% business. I didn't know who they were as people before they invested.	The first time I raised external capital I didn't do my homework, I didn't to a DD on the investors and ended up in a situation where we had very different views on how to run a business and how to handle teams and employees. They had a very short investment horizon. They wanted us to make an IPO after two years and raise a lot of capital. While we thought that we weren't ready. But they said: "We are majority owners and you have to execute on this." So, it is extremely important to know who you go to bed with.
Raising VC is like a wedding. You will be together for 10 years, so you need to be picky of whom you choose.	An important thing which I think is often missed in the initial discussions with investors is if you have common view on how you should grow the company. How fast should you grow? Which markets?
I think that value alignment is really important when you deal with investor. That you have the same values. I don't care much for investors who say that "we have 50 people who can help you within different questions in different areas." I'm not interested in that. I think that the people on the board should be really smart and sharp. And be involved and care about the company. Not arriving at a meeting every third month and say "Ok, can you let us know what happened since we last met?"	I would say that you need investors who have a similar culture to you, where you understand each other. And that you can work on honest and equal terms. If you don't have fun at work when you work in these kinds of companies, you won't cope since it's so much hard work. Since a lot of energy went to questions and conflicts among owners or bureaucracy issues, it took away my joy to work.

> You need to understand the hierarchy of a fund; partner, principal, associate. If an associate who has been six weeks with the VC shows interest in your company, it doesn't mean anything. You have one piglet who likes you, but it is the sow that is in charge.

In addition to understanding how the VC is set up it was also discussed how to receive knowledge about the actual investment process of the VCs. The main areas that were mentioned among the interviewees as important to read up on were the VCs' investment cycle (from deal screening to exit), technicalities behind the financial instruments used (e.g., preference shares, new issues of shares, convertible loan), and the logic behind startup valuations. There was also a need of understanding how future capital rounds work:

> I think it is quite good to read up on the different funding rounds; seed funding, early stage funding, series A, B and C funding rounds, to understand how they work. It is of course not the same amounts as in US but trying to convert it into a Swedish context is a useful exercise.

Even though much information can be found from books, web searches, and podcasts, many entrepreneurs emphasized the importance of having a mentor, advisory board or other types of experienced people to guide them through the process. Receiving advice directly from other entrepreneurs who had raised external capital themselves was often mentioned as important help along the way:

> We were lucky to quite early meet xxx who has built and sold his own company and who is now an angel investor. He very generously shared information and his own experiences from fund raising, which helped us a lot.

Table 4 offers additional support for how collecting information about the VC process beforehand mitigates the information asymmetry risks.

4.4. Building an open and honest relationship (Trust-building)

The final mechanism that emerged from our analysis was the trust between VCs and founders. By building an open and trusting relationship, the entrepreneurs mitigate the risk of moral hazard from the VCs. The "hidden actions" in this context refer to VCs acting opportunistically and not in the best interest of the founders and their startup. In our study we found several areas where the VC may act opportunistically and pursue their own self-interest. One example is when the VC pressures the entrepreneur to take excessive risk as the VC is diversified among a number of portfolio companies whereas entrepreneurs typically have their financial returns dependent upon the success of a single venture. Another example of opportunistic behavior and moral hazard is when the VC overpromises on value adding activities and insufficiently invests these non-financial resources into the firm due to time constraints or loss of interest in the particular startup. As one entrepreneur explained:

> The difficult thing with venture capital is that the VC usually has ten different portfolio companies. One of these might become a super success, two might return some money and the rest of their ventures will probably fail. So, the VC has the incentive to risk a lot to get one company to become a super star.

Table 4. Collecting information about the VC process beforehand (Preparation).

Gathering of information on the VC process beforehand	Understanding how VCs work	Understanding the VC process
Today there are at least ten podcasts that discuss the VC process. One good podcast is called "xxx." It describes a startup's journey from start to exit.	It is important to understand how venture capital works. You need to think about that the partner's time is the bottleneck. They only have time to sit in x amount of boards. That's why it sometimes can be more difficult to raise smaller amount.	That is their [the VCs] business model, to buy cheap and sell expensive. The reason to why they wanted to exit was probably because they felt that the company had stagnated and that they couldn't see any future value increase. So they thought that they might as well sell it.
My first advice is to choose a VC with experience from the industry. My second advice is that you do a proper DD on potential investors.	Different funds like different kind or risk, for example technical risk, marketing risk, founder risk. It is therefore meaningless to discuss with certain funds.	You need to learn the technicalities behind the financial instruments used. Preference shares, convertible loan and so on.
Take advice from someone who started and ran their own business before. And who has had experience from raising external capital.	I don't think I understood their [the VC's] intentions. What kind of return did they need? What kind of structure were they after? That made it difficult for me.	Understand valuations.
My dad has worked with financing before, so I have been able to ask him some things. Sometimes he has been able to help and sometimes not at all. But it has been nice to have him as a sounding board. But a lot I had to learn by myself.	Don't just look at the valuations. Read the book "xxxxx."	

Our findings suggest that interviewees use trust-building and honest and open communication to build a smooth relationship and avoid future conflicts. As discussed in the "matching" section, it is important to match the phase of the startup with the VC's strategy and earlier experience. If the founder is honest and clear about their current phase this will benefit the relationship with the investor.

> It is important to be clear about which phase your startup is in and to match this with the VC. If the VC thinks that you have gotten further, they might not accept that the company suddenly pivots and does something completely different which I think is quite usual in the very early phases.

One big advantage of venture capital is that the founders receive a sounding board to turn to in difficult times. Entrepreneurs and their startups exist in a complex and turbulent environment. When things do not go according to plan it is important that founders and investors can work and solve problems together. Important decisions often need to be taken quickly and with scant data, leaving little time to evaluate the other party's motive or hidden agenda. Consequently, it is important to build trust at an early stage and then maintain it by continuously working on building the relationship.

> Ensure that you have investors who are similar to you culture-wise, that you understand each other, and that you can cooperate on honest and fair terms. If you don't have fun at work when you work in these kinds of companies you will not cope since it is so much hard work. If you need to put a lot of energy into questions and conflicts regarding ownership it will take away the joy to work with this. That was what happened to me.

Since open and honest behavior from the entrepreneur will never control the VC in any formal way, as a contract does, it is questionable whether these mechanisms actually mitigates the risk of moral hazard or, instead, function as signaling mechanisms. Our findings suggests that there might be a difference between experienced and less experienced entrepreneurs. Based on our interviews, experienced entrepreneurs are more likely to use these mechanisms to manage moral hazard risks since at least they understand the importance of mutual trust or clearer contract terms, which indirectly might lead to fewer opportunities for the VC to act opportunistically. Table 5 provides additional examples of how experienced entrepreneurs use trust and open communication as a mechanism to mitigate information asymmetry risks.

5. Discussion

5.1. Entrepreneurial mechanisms to mitigate information asymmetry problems

The aim of this study was to investigate how entrepreneurs mitigate information asymmetry problems in a VC–entrepreneur relationship. Although certain scholars have acknowledged that problems arising from asymmetric information are two-sided (Carpentier and Suret 2006; Christensen, Wuebker, and Wüstenhagen 2009; De Bettignies and Brander 2007; Fairchild 2011; Shepherd and Zacharakis 2001), research has not examined how these problems are mitigated from the entrepreneur's perspective. This study contributes to the research on two-sided information asymmetry by identifying empirically how these problems are managed by entrepreneurs.

Table 5. Building an open and trusting relationship (Trust-building).

Being honest from the beginning	Having a good communication
It is very similar to a wedding I would say. If you start a relationship and things don't turn out the way you thought, it very easily ends in a bad divorce. Especially if you haven't been honest with each other from the start.	I don't have any problems with partners who disagree and argue, but what happened to us what that they didn't understand at all what we were doing. They could come to meeting and say things that weren't relevant for us at all.
We founders talked a lot about that it is not enough to have investors with good knowledge and strategic value; it has to be people in whom we trust and with who we could talk to if something went really bad.	Investors want to market and sell themselves as well, and some things they say might be . . ..overrated. I think that many startups tend to forget this . . . But this power balances can change quite quickly when the papers are signed. The terms might be quite advantageous for the investors and they can come and say "Now when we have had some time to think, our expectation is that you need to have a working business model in a year from now." I think that discussions like these might come as a shock to many founders.

Table 6 provides an overview of information asymmetry problems in a VC–entrepreneur relationship. The two columns to the right show different mechanisms used by VCs and entrepreneurs for mitigating the different information asymmetry risks. The VCs' mechanisms (e.g., screening, contracting, monitoring) have been studied by numerous scholars, whereas the entrepreneurs' mechanisms (apart from signaling) have been overlooked in current literature. Table 6 shows that the risk of adverse selection for the entrepreneur can be mitigated by matching, timing, and preparing. The risk of moral hazard for the entrepreneur can be mitigated by building trust and ensuring matching.

By considering both personal and strategic fit with the investors (matching), the entrepreneurs have to do due diligence on the investors and thereby decrease the risk of a bad match (adverse selection). By considering the timing and the reasons for raising the initial external capital, founders can better distinguish between venture capital and other financing sources (adverse selection). By collecting information about the venture capital process beforehand (preparing), the founders not only enhance their position to negotiate but also gather more knowledge on what to expect from a "good match" or a "good investor" (adverse selection). By building an open and trusting relationship and finding a good match with the investor, the entrepreneur increases the chances that their

Table 6. Mechanisms used by VCs and entrepreneurs to mitigate information asymmetry risks.

Information asymmetry risks			Mechanisms used by VCs	Mechanisms used by entrepreneurs
Adverse Selection	VC	To distinguish between good and bad ventures	- Screening/Due diligence - Specialization - Syndication	- Signaling
	Entrepreneurs	To distinguish between different funding alternatives and investors		- Matching - Timing - Preparing
Moral Hazard	VC	The risk of opportunistic behavior from the entrepreneur	- Staging of investments - Contracting - Monitoring - Trust-building	
	Entrepreneurs	The risk of opportunistic behavior from the VC		- Trust-building - Matching

interests and goals are aligned and decreases the risk of opportunistic behavior from the VC (moral hazard). The blank boxes in rows two and four show that we have not studied what VCs do to help entrepreneurs mitigate these problems, the same way as entrepreneurs use signaling to help VCs reduce theirs. Future studies should examine how VCs can support entrepreneurs in reducing their information asymmetry problems, perhaps by interviewing VCs with experiences of being entrepreneurs themselves.

This study investigated how entrepreneurs handle information asymmetry problems throughout the whole venture capital lifecycle. However, our findings suggest that most entrepreneurs use most of these tools in the pre-investment phase. Since adverse selection problems mainly arise pre-investment, entrepreneurs naturally need to use these tools before the investment, but for moral hazard problems that occur after the investment has been made, "building an open and trusting relationship" is the only tool used in the post-investment. This is an important finding: once the contract is signed, there seem to be few tools that can help entrepreneurs avoid problems that might arise from moral hazard.

5.2. Contribution to theory

The four themes described above are well-known by many experienced entrepreneurs, who sometimes share their anecdotal experiences through podcasts, blogs, books or mentorship programs. However, our goal in this study was to try to convert anecdotal evidence from entrepreneurs to more general knowledge and also to apply a theoretical perspective to the anecdotes. When reviewing studies of the entrepreneurial perspective on venture capital, we found few empirical findings concerning the information/knowledge gap between entrepreneurs and investors. Filling this gap is our main academic contribution.

Even though information asymmetry has been used before to explain the relationship between VCs and entrepreneurs (e.g., Amit et al. 1998; Carpentier and Suret 2006; De Bettignies and Brander 2007), this study provides three main contributions to the literature that further develop this field. The first contribution is in underlining how a two-sided agency perspective on a VC–entrepreneur relationship helps identifying mechanisms that mitigate information asymmetry risks. In most venture capital research, the VC is seen as the principal and the entrepreneur as the agent (cf. Arthurs and Busenitz 2003; Drover, Wood, and Fassin 2014). Since VCs have substantial power over firm activities and ultimately the exit strategy, we swapped the roles in this study and considered VCs as agents and entrepreneurs as principals. By reversing the roles, we were able to study the VC–entrepreneur relationship from another perspective. In so doing, we treated the entrepreneur as a more active part in the entrepreneur–VC relationship, reflecting what we view as an important part of reality. Most VC research views the investor as the leading party in the investment process and portrays the entrepreneur as a passive target. By contrast, this study suggests that entrepreneurs play a much more active role than is suggested by extant literature.

As raising venture capital is not a recurring event for novice entrepreneurs, they typically lack access to formal mechanisms similar to what VC firms have in place to mitigate risks. Instead, entrepreneurs need to develop their own mechanisms and informal tools along the way by relying on advice from entrepreneurs with prior venture capital experience. Several of the interviewees explained how they built knowledge through reading books and listening to podcasts. Many entrepreneurs especially emphasized the importance of having a mentor, advisory board or other types of experienced people to guide them through the process. Thus, building knowledge from other people's experiences therefore seems to have an important role in the learning process for entrepreneurs raising venture capital. We encourage scholars to further explore beyond the one-sided agency perspective of the VC–entrepreneur relationship.

The second contribution made by this study refers to uncovering mechanisms that entrepreneurs actively use to improve their relationship with a VC and reduce potential risks. As information asymmetry is recognized as a major problem (Amit et al. 1998; Landström 2017) as well as a prerequisite in the VC–entrepreneur relationship (without information asymmetry there would be no need for VCs), we explored the entrepreneurial experiences from the lens of information asymmetry theory. VCs are professional dealmakers and consequently have an information advantage over entrepreneurs in search of external funding. VCs are able to draft better contracts, benefit more from the relationship, or at least ensure that their risks are better hedged than those of the entrepreneurs. The better the entrepreneur is prepared for the negotiations and the better their understanding of VCs' investment process, motives, and other relevant issues is, the more likely it is that entrepreneurs will negotiate themselves suitable deals and maximize the relationship with their investors.

One relevant question when discussing information asymmetry from the entrepreneur's perspective is whether the VC is withholding information or simply has greater expertise, leaving the entrepreneur at a knowledge disadvantage. Based on this study's findings, both conditions are usually found in a VC-entrepreneur relationship. For very new and inexperienced entrepreneurs, there is indisputably a knowledge disadvantage and a need to learn and gather knowledge about the process. In this case it is not necessarily information asymmetry theory that might explain the behavior. However, as novice entrepreneurs gain experience of the funding process, their knowledge disadvantage diminishes. Hence, for more experienced entrepreneurs who know what to expect from the process, the VC's intended post-investment actions might indeed have been hidden from the entrepreneurs in the early discussions. Thus, information asymmetry theory most probably fits better when explaining less novice entrepreneurs' behavior towards VCs.

Relatedly, it is also important to distinguish between "managing VCs' asymmetric information advantage" and "mitigating problems from information asymmetry in a VC–entrepreneur relationship". The former refers to how entrepreneurs are at a knowledge disadvantage since they are novices while the VCs are experts, and that information is available to the entrepreneur through homework and due diligence. The latter refers to how entrepreneurs use the remaining mechanisms in order to reduce the risks of opportunistic behavior by the VC or negative experiences in the VC-entrepreneur relationship.

By focusing on the entrepreneur's perspective, we are following a research stream that acknowledges the entrepreneurs' influential role in fundraising (Bengtsson and Wang 2010; Drover, Wood, and Fassin 2014; Fairchild 2011; Hallen and Eisenhardt 2012; Hsu 2004; Valliere and Peterson 2007). In contrast to Valliere and Peterson (2007), we argue that entrepreneurs with experience do not have valuation and deal terms as the primary criteria when choosing VCs. In fact, out of our 20 interviewees, only one entrepreneur discussed how to receive higher valuations. Instead, several of the entrepreneurs discussed that one should not be blinded by high valuations but rather consider the type of money and the personal and strategic fit with the investor to increase the chances of a good relationship throughout the whole VC journey. This is partly in line with findings of Hsu (2004), who suggests that entrepreneurs are willing to forego offers with higher valuations to partner with more reputable VCs. Rather than focusing solely on reputation, this study suggests that there are other areas which can cause the entrepreneur to accept decreased valuations. Furthermore, this study agrees with Valliere and Peterson (2007) that entrepreneurs have little focus on “smart money” and value added services; however it also suggests that entrepreneurs find it important to have a VC who understands the business and industry.

In accordance with De Bettignies and Brander (2007) and Christensen, Wuebker, and Wüstenhagen (2009), this study confirms that the risk of moral hazard is present from the entrepreneur’s perspective. We contribute to these works by discussing how entrepreneurs handle this risk. Since most entrepreneurs do not have the option to negotiate in their contracts and cannot use this formal way of mitigating moral hazard issues, our study suggests that entrepreneurs mitigate this risk by building trust and ensuring a match. The fact that VCs have invested in several startups before usually gives the investors an information advantage, but in terms of moral hazard it can give the entrepreneurs an advantage since they are able to investigate the VC’s earlier moral hazard behavior with prior portfolio firms. We encourage scholars to further explore how information asymmetry influences the VC–entrepreneur relationship, perhaps by interviewing both entrepreneurs and VCs from the same dyad.

The third contribution of our study is that it provides a new perspective on matching and trust between VCs and founders. Only a handful of researchers have studied the two-sided need of both matching and trust in a VC–entrepreneur relationship in relation to information asymmetry and agency problems (e.g., Shepherd and Zacharakis 2001). Our study stresses the importance of these factors in mitigating information asymmetry problems from the entrepreneur’s perspective throughout the full process. In accordance with De Clercq et al. (2006), this study confirms the need of finding the right investor and ensuring a good match between the investor and entrepreneur. Whereas De Clercq and colleagues focus on the importance of complementary skills, our findings suggest that the entrepreneurs consider personal compatibility with the VC, similar view on expansion, and how to build a company as more important areas. To succeed with a good match, entrepreneurs have to understand what they need in terms of personal and strategic fit, but they also need knowledge about what is offered out there.

5.3. Contribution to practice

This study provides an important practical contribution to entrepreneurs and to practitioners aiming to support nascent entrepreneurs by gathering valuable advice on issues concerning venture capital funding. By reading about the experiences from the entrepreneurs in this study, nascent entrepreneurs can find helpful advice on how to manage and maximize their relationship with a VC. Even though much of entrepreneurial learning is said to be experiential in nature, reading about potential risks can help nascent entrepreneurs avoid the most obvious bumps. Several of the entrepreneurs in this study had been in incubator or accelerator programs. Almost all of these founders mentioned how venture capital was discussed as "the only option" for funding while there was little or no focus on alternative financing sources in the programs. Most coaching regarding financing concentrated around pitch training to VC investors and rarely discussed potential problems that may arise in this relationship with a VC firm or what founders should consider before raising venture capital. Therefore, this study can provide a more nuanced picture of venture capital funding, especially to entrepreneurs in incubators or accelerators.

Furthermore, this study acts as a counterweight to popular media and their reporting on venture capital. Instead of only reading about success stories and the actual moment of fundraising, entrepreneurs can receive a more unbiased view on the full VC–entrepreneur relationship. In Appendix B we provide a short list of what nascent entrepreneurs might consider before raising venture capital for the first time based on the experiences of the Swedish entrepreneurs who participated in this study.

6. Limitations

This study mainly focuses on institutional venture capital, which refers to VCs with a fund structure with limited partners. However, almost all interviewees had also been funded by other types of venture capital such as business angels, family offices, governmental venture capital, and corporate venture capital. An important finding in this study is that entrepreneurs need to understand advantages and disadvantages of different financing alternatives to reduce the risk of adverse selection. Choosing between venture capital and other financing alternatives is one aspect. The other aspect is choosing between various types of venture capital. Since entrepreneurs' motives for attracting venture capital differ, different types of investors can play different and complementary roles in their venture. This study has only scratched the surface of this last aspect and future studies could benefit from examining the entrepreneurs' experiences from different types of venture capital.

As is the case in all interview-based methodologies, there is a risk of sample bias. With regard to our sample, we acknowledge that a number of factors, particularly region, could influence their answers. We only interviewed Swedish entrepreneurs who have raised venture capital from Swedish and foreign VCs. Thus, we encourage similar studies in other regions. With regard to the risk of adverse selection, the terms "good or bad investor" are central terms. For a VC it is more transparent what a "good" or "bad" venture might entail, but from an entrepreneur's perspective, these terms are subject to more personal biases. Future research could benefit from further examining the matching between an entrepreneur and a VC and the terms "good" or "bad" investors from an entrepreneur's perspective.

Acknowledgement

Special thanks go to Anders Isaksson and Mats Lundqvist for helpful conversations and feedback.

Disclosure statement

No potential conflict of interest was reported by the authors.

Funding

I would like to thank the Chalmers University of Technology Foundation for their financial support.

References

Akerlof, G. 1970. "The Market for "Lemons": Quality Uncertainty and the Market Mechanism." *Quarterly Journal of Economics* 84 (3): 488–500. doi:10.2307/1879431.

Amit, R., J. Brander, and C. Zott. 1998. "Why Do Venture Capital Firms Exist? Theory and Canadian Evidence." *Journal of Business Venturing* 13 (6): 441–466. doi:10.1016/S0883-9026(97)00061-X.

Arcot, S. 2014. "Participating Convertible Preferred Stock in Venture Capital Exits." *Journal of Business Venturing* 29 (1): 72–87.

Arthurs, J. D., and L. W. Busenitz. 2003. "The Boundaries and Limitations of Agency Theory and Stewardship Theory in the Venture Capitalist/Entrepreneur Relationship." *Entrepreneurship Theory and Practice* 28 (2): 145–162. doi:10.1046/j.1540-6520.2003.00036.x.

Bengtsson, O., and F. Wang. 2010. "What Matters in Venture Capital? Evidence from Entrepreneurs' Stated Preferences." *Financial Management* 39 (4): 1367–1401. doi:10.1111/j.1755-053X.2010.01116.x.

Bollazzi, F., G. Risalvato, and C. Venezia. 2019. "Asymmetric Information and Deal Selection: Evidence from the Italian Venture Capital Market." *International Entrepreneurship and Management Journal* 15 (3): 721–732. doi:10.1007/s11365-018-0539-y.

Burchardt, J., U. Hommel, D. S. Kamuriwo, and C. Billitteri. 2016. "Venture Capital Contracting in Theory and Practice: Implications for Entrepreneurship Research." *Entrepreneurship Theory and Practice* 40 (1): 25–48. doi:10.1111/etap.12104.

Carpentier, C., and J. M. Suret. 2006. "Some Evidence of the External Financing Costs of New Technology-based Firms in Canada." *Venture Capital: An International Journal of Entrepreneurial Finance* 8 (3): 227–252. doi:10.1080/13691060600748421.

Christensen, E., R. J. Wuebker, and R. Wüstenhagen. 2009. "Of Acting Principals and Principal Agents: Goal Incongruence in the Venture Capitalist-entrepreneur Relationship." *International Journal of Entrepreneurship and Small Business* 7 (3): 367–388. doi:10.1504/IJESB.2009.023025.

Connelly, B. L., S. T. Certo, R. D. Ireland, and C. R. Reutzel. 2011. "Signaling Theory: A Review and Assessment." *Journal of Management* 37 (1): 39–67. doi:10.1177/0149206310388419.

Corbin, J., and A. Strauss. 2014. *Basics of Qualitative Research*. Thousand Oaks, CA: Sage publications.

Cumming, D. 2006. "Adverse Selection and Capital Structure: Evidence from Venture Capital." *Entrepreneurship Theory and Practice* 30 (2): 155–183. doi:10.1111/j.1540-6520.2006.00116.x.

De Bettignies, J. E., and J. A. Brander. 2007. "Financing Entrepreneurship: Bank Finance versus Venture Capital." *Journal of Business Venturing* 22 (6): 808–832. doi:10.1016/j.jbusvent.2006.07.005.

De Clercq, D., V. H. Fried, O. Lehtonen, and H. J. Sapienza. 2006. "An Entrepreneur's Guide to the Venture Capital Galaxy." *Academy of Management Perspectives* 20 (3): 90–112. doi:10.5465/amp.2006.21903483.

Dessein, W. 2005. "Information and Control in Ventures and Alliances." *The Journal of Finance* 60 (5): 2513–2549.

DeTienne, D. R. 2010. "Entrepreneurial Exit as a Critical Component of the Entrepreneurial Process: Theoretical Development." *Journal of Business Venturing* 25 (2): 203–215. doi:10.1016/j.jbusvent.2008.05.004.

Drover, W., L. Busenitz, S. Matusik, D. Townsend, A. Anglin, and G. Dushnitsky. 2017. "A Review and Road Map of Entrepreneurial Equity Financing Research: Venture Capital, Corporate Venture Capital, Angel Investment, Crowdfunding, and Accelerators." *Journal of Management* 43 (6): 1820–1853. doi:10.1177/0149206317690584.

Drover, W., M. S. Wood, and Y. Fassin. 2014. "Take the Money or Run? Investors' Ethical Reputation and Entrepreneurs' Willingness to Partner." *Journal of Business Venturing* 29 (6): 723–740. doi:10.1016/j.jbusvent.2013.08.004.

Eisenhardt, K. M. 1989. "Building Theories from Case Study Research." *Academy of Management Review* 14 (4): 532–550. doi:10.5465/amr.1989.4308385.

Fairchild, R. 2011. "An Entrepreneur's Choice of Venture Capitalist or Angel-financing: A Behavioral Game-theoretic Approach." *Journal of Business Venturing* 26 (3): 359–374. doi:10.1016/j.jbusvent.2009.09.003.

Fried, V. H., and R. D. Hisrich. 1994. "Toward a Model of Venture Capital Investment Decision Making." *Financial Management* 23 (3): 28–37. doi:10.2307/3665619.

Gifford, S. 1997. "Limited Attention and the Role of the Venture Capitalist." *Journal of Business Venturing* 12 (6): 459.

Gioia, D. A., K. G. Corley, and A. L. Hamilton. 2013. "Seeking Qualitative Rigor in Inductive Research: Notes on the Gioia Methodology." *Organizational Research Methods* 16 (1): 15–31. doi:10.1177/1094428112452151.

Gompers, P., and J. Lerner. 2001. "The Venture Capital Revolution." *Journal of Economic Perspectives* 15 (2): 145–168. doi:10.1257/jep.15.2.145.

Gompers, P. A., and J. Lerner. 2004. *The Venture Capital Cycle*. Cambridge, MA: MIT press.

Gorman, M., and W. A. Sahlman. 1989. "What Do Venture Capitalists Do?" *Journal of Business Venturing* 4 (4): 231–248. doi:10.1016/0883-9026(89)90014-1.

Gregory, D., K. Hill, I. Joy, and S. Keen. 2012. "Investment Readiness in the UK." *Big Lottery Fund*, July.

Hallen, B. L., and K. M. Eisenhardt. 2012. "Catalyzing Strategies and Efficient Tie Formation: How Entrepreneurial Firms Obtain Investment Ties." *Academy of Management Journal* 55 (1): 35–70. doi:10.5465/amj.2009.0620.

Hellmann, T., and M. Puri. 2000. "The Interaction between Product Market and Financing Strategy: The Role of Venture Capital." *The Review of Financial Studies* 13 (4): 959–984. doi:10.1093/rfs/13.4.959.

Hsu, D. H. 2004. "What Do Entrepreneurs Pay for Venture Capital Affiliation?" *The Journal of Finance* 59 (4): 1805–1844.

Hsu, D. K., J. M. Haynie, S. A. Simmons, and A. McKelvie. 2014. "What Matters, Matters Differently: A Conjoint Analysis of the Decision Policies of Angel and Venture Capital Investors." *Venture Capital* 16 (1): 1–25.

Jensen, M. C., and W. H. Meckling. 1976. "Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure." *Journal of Financial Economics* 3 (4): 305–360. doi:10.1016/0304-405X(76)90026-X.

Landström, H. 2017. *Advanced Introduction to Entrepreneurial Finance*. Cheltenham: Edward Elgar Publishing.

MacIntosh, J. G. 1994. *Legal and Institutional Barriers to Financing Innovative Enterprise in Canada*. Kingston, Ont: Government and Competitiveness, School of Policy Studies, Queen's University.

Manigart, S., K. Baeyens, and W. Van Hyfte. 2002. "The Survival of Venture Capital Backed Companies." *Venture Capital* 4, (2): 103–124. doi:10.1080/13691060110103233.

Pruthi, S., M. Wright, and A. Lockett. 2003. "Do Foreign and Domestic Venture Capital Firms Differ in Their Monitoring of Investees?" *Asia Pacific Journal of Management* 20 (2): 175–204. doi:10.1023/A:1023840432241.

Sahlman, W. A. 1990. "The Structure and Governance of Venture-Capital Organizations." *Journal of Financial Economics* 27 (2): 473–521.

Shepherd, D. A., and A. Zacharakis. 2001. "The Venture Capitalist- Entrepreneur Relationship: Control, Trust and Confidence in Co-operative Behaviour." *Venture Capital: An International Journal of Entrepreneurial Finance* 3 (2): 129–149. doi:10.1080/13691060110042763.

Silver, L., B. Berggren, and F. Veghohn. 2010. "The Impact of Investment Readiness on Investor Commitment and Market Accessibility in SMEs." *Journal of Small Business and Entrepreneurship* 23 (1): 81–95.

Valliere, D., and R. Peterson. 2007. "When Entrepreneurs Choose VCs: Experience, Choice Criteria and Introspection Accuracy." *Venture Capital: An International Journal of Entrepreneurial Finance* 9 (4): 285–309.

Van Maanen, J. 1979. "The Fact of Fiction in Organizational Ethnography." *Administrative Science Quarterly* 24 (4): 539–550. doi:10.2307/2392360.

Wilson, N., M. Wright, and M. Kacer. 2018. "The Equity Gap and Knowledge-based Firms." *Journal of Corporate Finance* 50: 626–649.

Zacharakis, A., T. Erikson, and B. George. 2010. "Conflict between the VC and Entrepreneur: The Entrepreneur's Perspective." *Venture Capital: An International Journal of Entrepreneurial Finance* 12 (2): 109–126. doi:10.1080/13691061003771663.

Appendix A. List of interview questions

Briefly provide a history of yourself and your startup

Can you walk me through the various financing stages of your company?

Pre-Investment phase

Why did you decide to raise external capital? Why venture capital?

Why did you choose this VC?

How and when did you make the first contact?

Did you raise external capital from other investors? From whom?

What was most difficult during the pre-investment phase?

What did you learn from this phase?

What did you know about this phase before?

If you were to give any advice on this phase to new entrepreneurs who are thinking about raising external capital, what would that be?

Post-Investment phase

Beside capital, what did the VCs contribute with after the initial investment?

What was most difficult during the post-investment phase?

What did you know about this phase before?

If you were to give any advice on this phase to new entrepreneurs who are thinking about raising external capital, what would that be?

Exit phase (if applicable)

Why did you do this type of exit?

When was the exit strategy decided?

What was most difficult during the exit phase?

What did you learn from this phase?

What did you know about this phase before?

If you were to give any advice on this phase to new entrepreneurs who are thinking about raising external capital, what would that be?

Insights

Was this your first startup?

If yes

Have you raised venture capital before? Why again?

Have you raised capital from the same VC as the first time?

Financing wise, what did you do different in your subsequent startup/s compared to your first startup?

If no

If you started a new company would you raise venture capital again?

If yes, would you raise with the same VC? If yes, why? If no, why not?

What would you do differently if you would raise venture capital for a new startup?

What are the most important insights from your VC journey/s?

What were the biggest surprises during your VC journey/s?

Which general advice would you give someone who is planning to raise external capital for the first time?

Appendix B. 10 things to consider before you raise venture capital for the first time

- Ensure that your reasons behind raising external capital are in line with venture capital functioning.

- Consider whether bootstrapping, family/friends or public grants/funding might be sufficient in the early stages.

- Be aware of the new expectations that will arise on both founders and startup once the first venture capital is raised.

- Have your founder team in place. It will be difficult to add new co-founders once the first round has been done.

- Be aware that raising venture capital and dealing with the VCs' requirements is a time and energy consuming process.

- Ensure that personalities fit between founders and investors. Ensure similar view on expansion plans and on risk and return mindset.

- Make your due diligence on the VC. Discuss with earlier portfolio firms.

- Gather information about the VC process beforehand (books, podcast, mentors).

- Understand how a VC works, both formally (what is their set up and how do they make money) and informally (who decides).

- Build an open and trusting relationship with the VC to align interests and goals.