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*Fairness theory applied to strategic  
alliance negotiations*

**MSc in Innovation and Entrepreneurship**

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## **Abstract**

This thesis investigates negotiation processes during strategic alliance formations between venture capital firms and start-up companies by empirically assessing previous literature on negotiation theory and further developing the understanding of fairness theory. The lack of empirical evidence surrounding alliances between venture capital firms and start-up companies is the basis for this research. Cross-sectional data have been obtained from seven different successful cases of short-term investments in the IT industry to further this endeavor. The roles of distributive, procedural, interpersonal and informational fairness in negotiations of strategic alliance formation are analyzed based on interview data. The results indicate that the higher the venture capitalists perceive fairness, the more likely the strategic alliance formations will be successful.

Keywords: Strategic alliances, Alliance formation, Negotiation theory, Fairness theory

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# 1. Introduction

## 1.1 Background

The concept of strategic alliances was first proposed by J. Hopland and R. Nigel in the 20th century (Yao, 2003). Hopland and Nigel defined strategic alliances as an agreement involving two or more organizations for achieving joint strategic goals in order to meet their business needs. Over the last two decades, this business strategy has caught the attention of academic scholars who then showed research interests in this area. At the same time, establishing strategic alliances is becoming one of the most central strategies for firms to develop their business (Hamel et al., 1989), which could help firms to conserve resources and share risks (Harrigan, 1988). Extensive research exists on joint ventures, nonequity alliances, and minority equity alliances (Keller, 1988), but no specific research exists on the business relationship between VCs and entrepreneurs. In this thesis, the relationship between the venture capital firm and the start-up company is defined as a *minority equity alliance*, which is characterized by one firm investing in another company and holds ownership shares in that company. However, as this definition is hard to apply on the VC's side since their involvement in the start-up company is weak (see p.7-8), we apply this definition from the start-up company's perspective. This thesis investigates why the business relationship can be defined as a strategic alliance and examines the formation phase of strategic alliances and the negotiation decision making process between VCs and entrepreneurs.

Initially, negotiation theory was involved in the social psychological study based on decision-making processes between negotiators (Druckman, 1977). With the development of few decades, negotiation theory has been widely used in various fields, such as law, commercial trade and social communication. During the negotiation process, it is inevitable that conflicts will emerge. Therefore, negotiation strategies are defined as mechanisms to manage different conflicts effectively (Das & Kumar, 2011). Considering the development of forming alliances to expand business, some scholars have paid attention to applying negotiation strategies in the field of alliance. The dual concern model proposed by Pruitt (1983), suggests that negotiators should



think about four alternative strategies to manage conflicts, namely “problem solving”, “contending”, “yielding” and “inaction” based on the concern for one’s own outcomes versus other’s outcomes. Das and Kumar (2011) suggests other similar alternative strategies, namely “problem solving”, “contending”, “yielding”, and “compromising”, which is more suitable for the situation of negotiation in strategic alliances.

From numerous academic studies, it is found that negotiation is influenced by many factors. Traditionally, researchers almost exclusively focused on the efficiency properties of both the process and the outcomes of a negotiation (Carraro, Marchiori & Sgobbi, 2005). Albin (1992) is the first scholar who pointed out that fairness plays an important role in negotiations. According to Colquitt’s (2001) study, fairness is best conceptualized as four distinct dimensions: procedural fairness, distributive fairness, interpersonal fairness, and informational fairness. Fairness theory was first used in the research on the fairness among people. Luo (2005) started to utilize fairness theory to study the fairness among organizations in the formation of strategic alliance. Following Luo’s (2005) research, Ariño and Ring (2010) use fairness theory to conduct another study on the joint venture alliance formation. Apart from these researchers, the application of fairness theory in the formation phase of strategic alliance did not draw the attention of other researchers and lacks further academic literatures. As this research field has received sparse attention, this thesis is influenced and encouraged to investigate this topic.

Although the significance of negotiation theory and fairness theory has been well acknowledged during the last decades, few researches focus on using both of these theories to analyze strategic alliances in the formation phase. Therefore, the motivation behind the research of investigating how fairness influences alliance formation is based on this fact.

## **1.2 Objectives and research question**

The first motivation of this thesis is our ambitions to become future entrepreneurs which require us to understand the venture capital industry. The second motivation stems from suggestions by our supervisors who encouraged us to further investigate the fairness theory. Last, the scarcity of

empirical assessment on effects of different negotiation strategies in strategic alliance formation leaves opportunity for further investigation.

Main research objectives are showed as follows:

1. to examine the current successful alliances by utilizing the fairness theory and the negotiation theory
2. to provide entrepreneurs an insight of venture capital negotiation process and VCs' thoughts during the process

The research question has been changed several times. On the basis of the high failure rate of forming alliance which is between 30% and 70% (Bamford & Gomes-Casseres, 2004), the first proposed research question was: *What are the significant factors that lead to a successful alliance?* However, this research question did not show insights of how these factors determine outcomes of the entire alliance. Therefore, the second version of the research question was presented as: *How do significant factors affect the entire alliances process?*

Review of previous literature and testing interview data has been gathered, providing more understanding of the whole process by which to establish alliances between venture capitalist firms and start-up companies. Both literature review and data collection helped us to develop our final research question. Considering the short time period, it is difficult to elaborate the whole process of alliances. Therefore, this study will only focus on the alliances formation phase.

The negotiation strategy is an important factor that can influence the success of forming alliances. However, current studies of empirical assessment on the effects of different negotiation strategies in the phase of alliances formation remain sparse. For example, one of the latest studies about applying negotiation strategy in the research field of alliance conducted by Das and Kumar (2011) primarily focuses on the theoretical development, as he said: *“the purpose of this paper is propose a strategic framework for understanding inter-partner negotiation dynamics in alliances”*. One of the limitations of his study is the lack of empirical assessment to prove the strategic framework. This thesis is primarily motivated to increase deeper understanding of empirical effects of the strategic framework arising from this limitation.

Furthermore, with the development of fairness theory, more researchers utilize this theory to analyze the insights of alliances. For instance, Ariño and Ring (2010) investigate the theory of distributive, procedural, interpersonal, and informational fairness in a failed international joint venture case to analyze the roles of their occurrence during the alliance formation phase. However, the lack of multiple-case studies of successful alliance formations constrains his research to some extent. Therefore, the question of how fairness theory works in successful alliance cases has been raised. All these limitations encourage this thesis to propose its research question: *How do perceptions of fairness affect negotiation outcomes during strategic alliance formation between VC firms and start-up companies?*

### **1.3 Delimitation**

Given that it is very difficult to access an ongoing negotiation process between VCs and entrepreneurs, the longitudinal design was not suitable for this research. The time limitations of the research hindered the researchers' ability to perform a time-series study. Thus, the cross-sectional design was selected for this study. As Wilson (2010) mentioned, the cross-sectional design is less time-consuming and less expensive than a longitudinal study.

Short term investment cases of IT industry at the early stage were chosen as the research objects in this study. But it is noticeable that this study mainly focused on the successful cases. Failed cases were introduced in interviews and mentioned in the case presentations, but the in-depth analysis for these failed cases was not conducted in this study.

### **1.4 Chapter outline**

The master thesis is structured as follows:

**Chapter 1- Introduction** briefly introduces the background of this study as well as the research objectives and research question.

**Chapter 2 - Literature review** provides an extensive literature overview of strategic alliance formation, negotiation theory, and fairness theory. This chapter also acknowledges several researchers who have conducted their studies related to our chosen study topic.

**Chapter 3 - Methodology** describes the research design, research methods, and data analysis. Case study was chosen to analyze our research. This is then followed by research methods which consist of research setting and data collection. In the data analysis section, new findings are presented.

**Chapter 4 - Case presentations** provides an overview of negotiation process in strategic alliance formation, elaborates on each interview, and presents the data by focusing on fairness, negotiation strategy and other coded concepts.

**Chapter 5 - Discussion of findings** discusses the new findings of our research and interprets these findings by implementing previous literature. In addition, both proposed framework and propositions are illustrated in this chapter.

**Chapter 6 - Conclusion** summarizes our findings and concludes the contributions of our research. Limitations and future research are also discussed.

## 2. Literature review

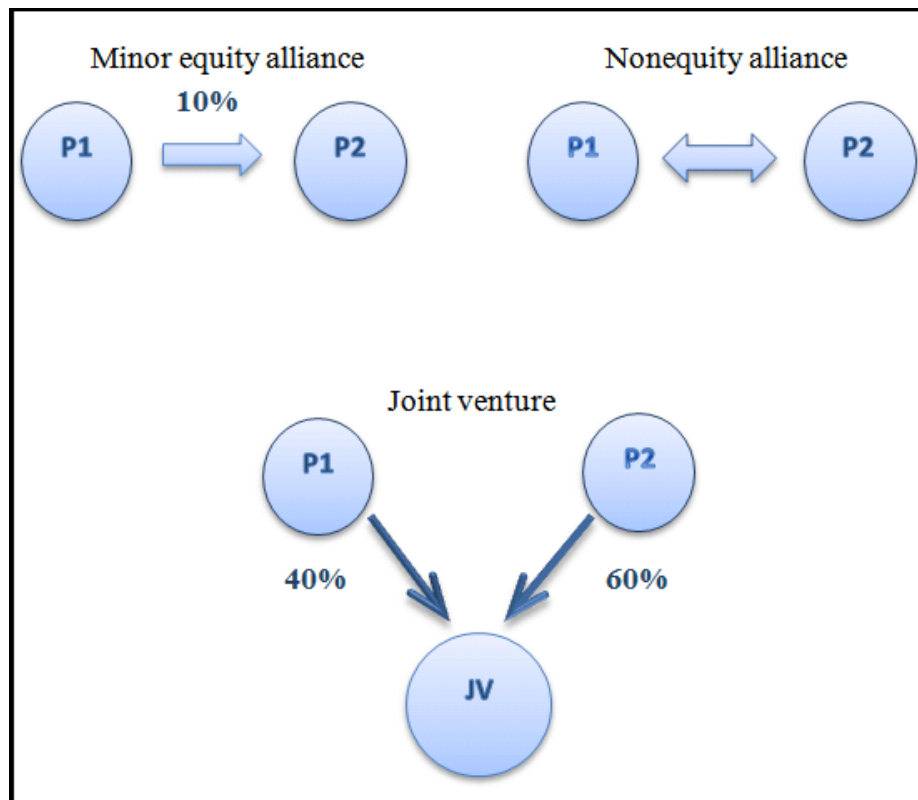
### 2.1 Alliances

#### 2.1.1 The concept of Alliances

Linkages between firms have existed since the establishment of the very first companies. These linkages could be for example trading partners where necessary resources or services are provided to one another to enhance the firms' business performance. In the last two decades, the concept of alliances has influenced the business world greatly and has paved the way for many start-up companies and introduced them to another dimension in the competitive business world. There are many different ways to define the term alliance since it has been used in different settings, but the core *meaning* of the term can be described as *a cooperative relationship between two independent entities who work under an informal contract* (Reuer et al., 2011). An informal contract is a contract that does not necessarily have all the terms specified in advance, but where firms use open-ended contracts to govern their business relationship (Reuer et al, 2011).

On a deeper level, *strategic* alliance is a term that has been used considerably in the academia and in the business world in the recent years and differs from the original term (alliance). Because a range of various definitions exists on the strategic alliance term, Yoshino and Rangan (1996) created three characteristics for the strategic alliance definition: (1) firms remain independent after the alliance formation, (2) partner firms share the benefits and control over the performance of assigned tasks, and (3) partner firms contribute in one or more key strategic areas (e.g. technology, market, and customers) on a regular basis. Therefore, strategic alliance can be formulated as *a formal relationship between independent firms on a longer-term basis where they agree to work together to enhance the competitive advantage by discovering and creating new possibilities and exploiting new skills and resources*. Even though alliance takes different forms, there are some similarities that draw upon them. J. Peter Keller (1988) proposed three different types of strategic alliance: joint ventures, nonequity alliances, and minority equity alliances. A joint venture is a newly incorporated company created by two or more firms where every partner has an ownership and representation on the board of directors. Nonequity alliance is an agreement to cooperate in some way between two partners where no new entity is being

created or any equity holdings between partners. Minority equity alliance resembles nonequity alliance in that partners agree on a business relationship without creating a new company, but where one partner holds an equity in the partner firm. Figure 2.1 illustrates these three types of strategic alliances.



**Figure 2. 1 An overview of three types of strategic alliances**

Based on the knowledge of alliance, the investment between a venture capital firm and a start-up company as a *strategic alliance is defined*. From hereby, venture capital will be referred to as VC and venture capitalists as VCs. It is argued that this relationship fulfills the criteria provided by Yoshino and Rangan (1996). The reasons are as following:

**(1) Firms remain independent after the alliance formation**

The start-up company still remains independent after the investment even though the VC firm holds a certain amount of share in the company.

**(2) Partner firms share the benefits and control over the performance of assigned tasks**

The entrepreneur and the VC firm can discover new possibilities and perform certain task together where both parties can benefit from the outcome.

**(3) Partner firms contribute in one or more key strategic areas (e.g. technology, market, and so on) on a regular basis**

Besides from providing capital, VCs can also give advice and provide resources.

In the light of these elaborations, the relationship between the venture capital firm and the start-up company is defined as a strategic alliance and specifically as a *minority equity alliance*. However, as this definition is hard to apply on the VC's side since their involvement in criteria 2 is weak. We determine this definition from the start-up company's perspective.

From here on, the alliances between VCs and entrepreneurs will be referred to as strategic alliances.

### **2.1.2 Investment criteria**

To broaden our understanding of the venture capitalist world, how VCs make investment decisions is looked into. The starting point is based on the criteria VCs use to evaluate a potential investment. The reason for looking into this topic is to understand which sections VCs and entrepreneurs negotiate about and which sections are more important than others. Also, this is used as preparation for the interview with the investors. It is believed that many of these points mentioned under will also be topics that the investors will elaborate on during the interview. The fairness theory and negotiation strategies are used later to interpret the relationship between the VCs and entrepreneurs. This literature is based on the findings done by Fried and Hisrich (1994) where they found fifteen criteria common for VC investments. Their criteria expand the three basic fundamentals (see Table 2.1 of Investment criteria) defined by Hisrich and Jankowicz (1990): concept, management, and return.

**Table 2. 1 Investment criteria**

<b>Concept describes the requirements for the business idea and consists of four elements:</b>
A potential for growth of earnings (for example, growing market, extend market share or reduce costs).
A business idea that is ready to go to market or can brought to market within 2 to 3 years.
The idea must offer a competitive advantage or be in a non-competitive industry.
A reasonable capital requirement for the idea
<b>Management describes the attributes that VCs wish to see in managers:</b>
Personal integrity
Good track records (earlier work experience)
Realistic - be able to identify risks and develop plan for dealing with these risks
Hard working
Flexible
Understand the business on an in-depth level
Possess leadership skills to handle both good times and pressure
General management experience
<b>Return (exit):</b>
Provide an exit opportunity (for example by public offerings, sale of the company or buyback by the company)
Potential for a high rate of return
Offer a potential for a high absolute return

### **2.1.3 Investment decision making process**

By looking into investment decision making criteria, an understanding of what VCs emphasizes during the negotiations with entrepreneurs is created. According to several researchers, the venture capitalists go through a number of stages during the decision making process. These various findings agrees that an investment decision making process consist of five to six stages (Wells 1974, Tyebjee & Bruno 1984, Silver 1985, Hall 1989), see Table 2.2. Fried and Hisrich (1994), who carried out the research on investment criteria, also did a research on decision making process. Their presentation of the findings resembles the earlier findings discovered by various researchers. Their main difference is the last (sixth) stage. Fried and Hisrich (1994) described it as the closing stage where the VCs decides to or not invest, while earlier researchers refer their last stage to cashing out as in exiting the company. According to Fried and Hisrich (1994), an investment negotiation takes an average of 97.1 days to pass through the six stages.



**Table 2. 2 Stages of negotiation process<sup>1</sup>**

<b>Process Stage</b>	<b>Wells (1974)</b>	<b>Tyebjee &amp; Bruno (1984)</b>	<b>Silver (1985)</b>	<b>Hall (1989)</b>
1	Search	Deal origination	Search	Generating deal flow
2		Screening	Initial Screen	Proposal screening Proposal assessment
3	Evaluation	Evaluation		Project evaluation
4			Due diligence	Due diligence
4		Deal structuring	Deal structuring	Deal structuring
5	Venture board meetings and operations	Post investment activities	Monitor progress	Venture operations
6	Cashing out		Cashing out	Cashing out

It is decided in this thesis to include this topic because the investment decision making process is very similar to the alliance forming process and is also one of the reasons why the investment between a VC firm and a start-up company as an alliance is defined. The five stages in the investment decision making process will be outlined and a brief comparison with the alliance formation process will be made. A combination of the processes defined by Wells (1974), Tyebjee and Bruno (1984), Silver (1985), Hall (1989), and Fried and Hisrich (1994) will be used when describing the stages, but for the last (fifth) stage Fried and Hisrich (1994) (see Appendix 1) is used as reference because it has the closest resemblance with the alliance forming process.

- Stage 1 Deal search

VCs get new deals through several ways; some deals come in from referrals, many are sent by emails, and some VCs meet the entrepreneur at seminars and conferences.

- Stage 2 Screening

VCs review the incoming investment proposals (often an executive summary and/or a business plan) based on their own criteria on investment size, industry, geography, location, and stage of financing. Proposals that don't meet the criteria will be eliminated.

---

<sup>1</sup> Source: Hall & Hofer (1993), p. 28

- Stage 3 Evaluation

During this stage, the VCs breaks down the business plan in part and tries to understand the business model. The VCs does extensive research on the technology, market, management team, and so on by hiring external experts to do evaluations. VCs consult their network for advices and to check for potential customers or suppliers. The entrepreneur is to lay out the financial projections. This is the stage where the VCs perform the due diligence.

- Stage 4 Deal structuring

During this phase, the VCs may have developed an emotional tie to the proposal. This is also where they decide whether to invest or not. During this phase, the VCs and entrepreneur do the number crunching on the value of the company, ownership shares, return on exit, and so on. Legal documents are formed where they negotiate the terms and condition and do changes if the parties are not satisfied with the proposed terms, for example, the VC wants to change the management team. This is the term sheet phase, where the heavy negotiation takes place.

- Stage 5 Closing

In the last phase of the process where negotiation over the terms and condition are over and where legal documents are signed. After the signing of the deal, the company receives the money.

#### **2.1.4 Stages of alliance formation**

The formation of an alliance has been researched on for several decades. Earlier researchers concluded that there are several stages in an alliance formation which have key factors that are important for a successful outcome of the negotiation of a deal (Gulati 1998)/ (Borch, 1994; Kanter, 1994; Larson, 1992). The development process models provided by the different researchers' range from a five-stage model to a seven-stage model, where the stages are organized in phases, see Appendix 2. When analyzing these models, it is recognized that the formation phase has some resemblance with the investment decision making process.

The formation phase consists of all the stages that exist in the investment decision making process. During the alliance formation phase, it is found that the partner locating and selection

stage, where they search for potential partners and select the right partner to cooperate with. The next stage is engagement, where the partners learn about each other and learn about the business, and evaluations. The fourth stage is negotiation and the last stage is where they decide whether to cooperate or not.

The comparison of the negotiation decision making process and the alliance formation phase is illustrated in Table 2.3.

**Table 2. 3 Comparison table between investment decision making process and alliance formation phase<sup>2</sup>**

<i>Reference from literature</i>	<b>Investment decision making process</b>	<b>Alliance formation phase</b>	<i>Reference from literature</i>
<i>Hall (1989), Silver (1985), Wells (1974)</i>	<b>Deal search</b>	<b>Locating partners</b>	<i>Brouthers et al. (1997)</i>
<i>Hall (1989), Tyebjee &amp; Bruno (1984), Silver (1985)</i>	<b>Screening</b>	<b>Selecting partners</b>	<i>Das &amp; Teng (1997), Kanter (1994)</i>
<i>Wells (1974), Tyebjee &amp; Bruno (1984), Hall (1989)</i>	<b>Evaluation</b>	<b>Engagement</b>	<i>Kanter (1994), Speakman et al. (1996)</i>
<i>Tyebjee &amp; Bruno (1984), Silver (1985), Hall (1989)</i>	<b>Deal structuring</b>	<b>Negotiation</b>	<i>Brouthers et al (1997), Das &amp; Teng (1997), Ring &amp; Van de Ven (1994)</i>
<i>Fried &amp; Hisrich (1994)</i>	<b>Closing</b>	<b>Commitment</b>	<i>Kanter (1994)</i>

According to Das and Kumar (2011), the negotiation of an agreement between the potential partners is the central issue at the phase of alliance formation. Further literature review regarding negotiation is illustrated below.

<sup>2</sup>Based on: Das & Teng, (2002), Hall & Hofer (1993)

## 2.2 Negotiation theory

### 2.2.1 The concept of negotiation

Negotiation theory is a social psychological study that looks at decision-making processes between negotiators (Druckman, 1977). It seeks to identify the variables that determine the outcome of negotiations, bargaining power, and power relations by using game theory<sup>3</sup> (Carraro, 2005). Negotiation theory has been developed for a few decades that involve many researchers. Druckman (1977), Bazerman and Neale (1992), Pruitt and Carnevale (1993), and Zartman (1994) have made a great contribution for the negotiation theory development. Major parts of the negotiation theory concern the details of decision-making during the process of bargaining and mediation (Pruitt, 2001). Much of the negotiation theory has the same notion of negotiation as a communication process by two or more parties, but quite different in the description of the processes. For example, structural analysis emphasizes on the perspective of power during this process; game theory or strategic analysis considers this process as a repetition of games; integrative analysis describes this process as successive procedures<sup>4</sup>.

Negotiation was defined as an interactive communication process by two or more parties who need to find an optimized way to coordinate their behaviors (Korobkin, 2002). It is frequently used in different social activities in order to make an agreement. According to the book of *Negotiation: Theory and Strategy* (2002), there are three main steps in the negotiating process. First, it begins with pre bargaining preparation. Then during the communication phase, negotiators exchange information, make offers and counteroffers. In the end, the bargaining interaction concludes with reaching an agreement or not. Negotiating in this order is a very common process. However, in real life negotiation process, negotiators would like to undertake a different order. For example, during our interviews with investors, some interviewees chose to propose an offer to the entrepreneur before entering the pre bargaining phase. It is not so hard to understand their choice, because they do not want to lose the opportunity of a good investment.

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<sup>3</sup> Game theory is the study of strategic decision making. More formally, it is the study of mathematical models of conflict and cooperation between intelligent rational decision-makers (source:[http://en.wikipedia.org/wiki/Game\\_theory](http://en.wikipedia.org/wiki/Game_theory)).

<sup>4</sup> Source: [http://en.wikipedia.org/wiki/Negotiation\\_theory](http://en.wikipedia.org/wiki/Negotiation_theory)

In order to understand the complex process of negotiation, it requires the development of conceptual frameworks. The following articles are focusing on this purpose.

Carrie Menkel Meadow (1983) published her paper on the problem solving structure in the negotiation. She presents two types of negotiations: problem solving negotiation and adversarial negotiation, which depends on if negotiators intend to use bargaining to make both parties better off or gain benefits at the cost of their opponent (Korobkin, 2002). Russell Korobkin (2000) suggested that negotiations could be classified as “zone definition” and “surplus allocation” (Korobkin, 2000). In his framework, he uses the concept of tactics that are defined by if they help negotiators to understand the “parameters” of bargaining zone or allocate the cooperative surplus in order to make progress for both sides (Korobkin, 2002). Some parts of negotiation theory are relevant to only one type of negotiation, while others cut across all types of negotiation (Pruitt, 2001). Ripeness theory describes the conditions under which negotiation will begin, covering all types of negotiation, which helps us to understand how negotiation theory works in different kinds of negotiation (Zartman 1989, 1996, 1997).

Given that negotiation is a dynamic and interactive process, the final agreement or success highly depends on negotiators’ ability to understand their opponents’ needs and respond to their negotiating methods. With years of practice in the negotiation process, negotiators will probably handle different issues in any situation that might threaten the success of negotiation. However, it is necessary to conclude theoretical approaches that help negotiators to better understand the structure of negotiation and the principles of negotiating approach, which could enable negotiators to become more effective bargainers. Therefore, Korobkin (2002) attempts to provide a manageable analytical framework in his book based on strategic goals. After analyzing the negotiating process from a structural perspective, he thinks negotiators always attempt to find the bargaining zone and try to expand it in order to enlarge their cooperative surplus for the agreement (Korobkin, 2002).

In addition, Korobkin also presents some analytical categories which can be used to organize the negotiation dynamics, such as negotiators’ dilemma and conflict style (Korobkin, 2002). Negotiator's dilemma describes the situation of whether to share information with opposing

negotiators freely or not. This is one of the most critical strategic choices that negotiators have to make. During our interviews with investors, some of them suggest that entrepreneurs should be honest and freely share relevant information with them, which are very crucial to support the effective negotiation process. On the other side, conflicts will deeply affect the negotiation process. Conflicts during the negotiation process may arise from psychological or behavioral dissatisfaction, which could cause negotiators to become defensive or offensive. As a result, it will be hard to be rational during the following negotiating steps.

### **2.2.2 Conflict**

Conflict occurs when “disagreements exist in a social situation over issues of substance” (Schermerhorn, 2003), which is inevitable to avoid during the negotiation process. Early conflict researchers, such as Mack and Snyder (1957) defined conflict as “a particular kind of social interaction process between parties who have mutually exclusive or incompatible values” (Mack, 1957, P.212). Although there were many similar views about conflict processes, many argued the importance of conflict outcomes (Schmidt & Kochan, 1972; Pondy 1967). With the development of social science, more and more researchers paid attention to other definitional contrasts of conflict, such as the objectives versus perceived incompatibility of actions (Hocker & Wilmot, 1985).

When negotiators move into the negotiation process, they need to cope with different types of conflicts. According to Schermerhorn’s definition of conflict, there are two main types of conflicts: Substantive and Emotional. Substantive conflict is “a fundamental disagreement over ends or goals to be pursued and the means for their accomplishment” (Schermerhorn, 2003). Emotional conflict arises from interpersonal difficulties of personality differences. Harinck (1999) and other researchers believe that negotiation itself is to discuss and resolve differences which might be traced back to interest conflicts in scarce resources, intellectual problems (e.g., “what is the right answer?”) or evaluative problems (e.g., “what is good or bad?”) (Coombs, 1987; De Dreu, Harinck, & Van Vianen, 1999; Kaplan, 1987; Kaplan & Miller, 1987; Kelley & Thibaut, 1969; Laughlin, 1980; Laughlin & Ellis, 1986; Levine & Thompson, 1996). Therefore,

the question of how to solve these conflicts has appeared. The negotiation strategies are mechanisms to manage different conflicts effectively (Das & Kumar, 2011).

### 2.2.3 Negotiation strategy

Previous literatures demonstrate different perspectives on how to manage conflicts. In terms of *disputants'* endeavors, for many reasons, such as "*the net cost of the conflict becomes unacceptably high, resources are depleted, goals change, and new alternatives surface*" (Blalock, 1989), they attempt to manage conflicts. Table 2.4 shows some operations that disputants performed.

**Table 2. 4 Disputants' Conflict Management Tactics<sup>5</sup>**

---

Prescriptive

- Be aware of the conflict causes and results
- Note the alternatives
- Take steps to deal with the causes, conflict and results
- Attempt to change the other, the conditions, and one's own behavior
- Improve mood
- Express disagreement in a reasonable fashion
- Link actions to positive goals
- Openly discuss opposing views
- Address dispute concomitantly from own and opponent's position
- Hold to functional values
- GRIT

Descriptive

- (The above prescriptive approaches can also be included in this category)
  - Violence and competitive use of force
  - Agree to symbols of defeat
  - Compromise
  - Convert the opponent
  - Totalist: attempts to completely beat the opponent
  - Totalist approach with interim agreements
  - Deterrence plus punishment
  - Mixed, firm but cooperative approach
  - Conciliation
  - Latent acceptance, accommodation
  - Forcing
  - Avoiding
  - Compromising
  - Problem-solving (collaboration)
- 

<sup>5</sup>Source: James A. Wall (1995)

In terms of prescriptive statements, Deutsch suggested that disputants should be firstly aware of the causes and consequences of conflict and alternatives to it (Deutsch, 1990). After that, disputants need to cope with the causes of conflict, the conflict itself and its effects step by step. Similarly, Hocker and Wilmot pay more attention to the causes of conflict, but less attention to interpersonal dynamics (Hocker, 1991). They think that disputants should change their own behaviors, the conflict conditions, and their opponents' behaviors. Kottler (1994) thinks that disputants should focus on their own responsibility and prevent to blame others. Eiseman and Gray demonstrate a type of integrative thinking in which disputants think about the conflict concomitantly from their own perspective as well as their opponents' (Eiseman, 1978; Gray 1985). They also emphasize the value of openness, integrity and justice (Wall, 1995). GRIT (Graduated and Reciprocated Initiatives in Tension-reduction) approach is advocated by Osgood (1962). He presents the idea that disputants should take "a set of trust-building steps, such as announcement of his or her steps ahead of time, establishment and observation of a timetable, advocating reciprocity and cooperation reward" (Wall, 1995, P.537).

On the other side, the actions taken by disputants to manage conflict have been appeared from the descriptive base. Researchers point out that disputant can proceed in a trial fashion: "one approach is tried; the disputants then move to another approach which is effective for a while; lastly, they try something else" (Wall, 1995, P.537). In addition, Coser (1967) thinks that disputants may turn to violence to be sure they can overcome their opponents. Later, Kriesberg (1992) also agree with Coser's opinion. However, he focuses on the point that disputants may compromise, withdraw, or convert the opponent to manage conflict. There are numerous literatures related to conflict management that demonstrate on one specific aspect of negotiation skills. But Blake (1964) and Mouton (1970) develop a "two-dimensional grid": one concerns for production and the other one concerns for people. Subsequently, other scholars develop this two-dimension as "assertiveness" versus "cooperativeness" (Thomas, 1976), "concern for one's own outcomes" versus "concern for other's outcomes" (Pruitt, 1983).

As playing a game like chess, it is wise to keep in mind that strategies need to be flexible in order to fit the dynamics. It is hard to detect insights before negotiators involve themselves into



the first meeting. Therefore, negotiators have to make good preparations for the following negotiating phases and establish alternatives to be sure you will freely face different situations.

#### **2.2.4 Negotiation strategy in alliance**

With the development of forming alliance to expand business, some scholars have paid attention to applying negotiation strategies in the field of alliance. Dual concern model (Pruitt, 1983) suggests that negotiators should think about four alternative strategies to manage conflicts, namely “problem solving”, “contending”, “yielding” and “inaction” based on the concern for one’s own outcomes versus other’s outcomes. Specifically, “Concern about both one's own and other party's outcomes encourages a problem-solving strategy; concern about only one's own outcomes encourages contending; concern about only the other party's outcomes encourages yielding; concern about neither party's outcomes encourages inaction”(Pruitt,1983). Problem-solving strategy seeks to reconcile the parties' aspiration that includes increasing available resources, compensation, exchanging concessions on low priority issues, minimizing the costs of concessions, and creating new mutually beneficial options. Therefore, the advantage of problem solving strategies is that both parties yield the best outcomes; Contending strategy seeks to persuade the other party to agree to a solution that favors one's own interests; both yielding strategy and inaction strategy will reduce their aspirations, but yielding strategy is an effective way to close negotiations when issues are unimportant and time pressures are high; inaction strategy is usually used to increase time pressure on the other party (Pruitt, 1983).

This dual concern model has been proved to be valuable in the field of conflict management (De Dreu et al., 2001). However, it is seldom to find enough demonstration on negotiation in the field of strategic alliance from literatures. Some researchers have presented some factors that may affect the outcome of forming alliance on a specific perspective. For example, Leung (1996) suggests the important role of fairness in joint venture. And Luo (2005) presents the influence of justice perception in alliance. Some other studies about negotiation strategy in alliance are listed in Table 2.5.

**Table 2. 5 Recent studies of negotiation strategy in alliance<sup>6</sup>**

<b>Author</b>	<b>Year</b>	<b>Description</b>
Kwok Leung, Peter B. Smith, et al.	1996	“Differences in satisfaction as a function of the cultural origin of expatriate managers in joint venture may be due to differences in perceived performance-based and comparative distributive justice” (p.957)
Asha Rao and Stuart M. Schmidt	1998	“We incorporate constructs from power dependence, transaction cost, and game theory to develop and test a behavioral model of the negotiating influence tactics in international alliance” (p.666)
Paul Tracey and Gordon L. Clark	2003	“The nature of some aspects of firms’ alliance environment may be negotiated through networks of social interaction between agents and their counterparts in other relevant organizations” (p.3)
Arino and Reuer	2004	“Executives need to balance the costs of negotiating, monitoring and enforcing complex contracts against the threat of opportunistic behavior” (p.38)
Luo	2005	“My analysis suggests that perceptions of procedural justices shared by both parties have a positive relationship with alliance profitability and perceptions of procedural justice shared by both parties have a stronger positive link with profitability than do individual parties’ ” (p.705)
Parry et al.	2008	“We hypothesized that integrative potential was higher in decisions involving R&D task conflict than in decisions involving marketing task conflict” (p.211-212)

Although lots of researchers have admitted the importance of dual concern model, it does not discuss compromising as one of the most important strategies (Das & Kumar, 2011). Therefore, Das and Kumar (2011) suggests other similar alternative strategies, namely “problem solving”,

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<sup>6</sup> Based on: Das, T. K. and R. Kumar (2011)

“contending”, “yielding”, and “compromising”. These strategies are defined in Table 2.6. There are some reasons for using this model as research framework to discuss negotiation strategies in alliance. Firstly, the first three strategies have already proved to be valuable in previous literatures (De Dreu, 2001). Secondly, it is suitable for the situation of negotiation in alliance, where negotiators need to keep the balance between concern for one’s own outcomes and others. Thirdly, if negotiators are willing to compromise in negotiating alliance, it is possible to make an agreement at hand even it may not be a final integrative one (Das & Kumar, 2011).

**Table 2. 6 Dual Concern Framework<sup>7</sup>**

<b>Problem solving</b>	<i>“Problem solving strategy is associated with a concern for a member firm’s own outcomes and an equally salient concern for its partner’s outcomes”.</i>
<b>Contending</b>	<i>“Contending strategy implies a high concern for one’s own outcomes accompanied by a low concern for the partner’s outcomes”.</i>
<b>Yielding</b>	<i>“In a yielding strategy the partner firms reduce their demands or concede to what the opponent is expecting of them. Concern for other’s outcomes is high and concern for one’s own outcomes low”.</i>
<b>Compromising</b>	<i>“Compromising strategy implies a moderate amount of concern for one’s own outcomes as well as for the other party’s outcomes”.</i>

Given the importance of his dual concern framework, this framework will be followed up and its empirical applications in the alliance of venture capital investment will be explored.

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<sup>7</sup> Source: Das, T. K. and R. Kumar (2011)

## 2.3 Fairness theory

### 2.3.1 The concept of fairness

Negotiation is obviously affected by multiple factors. Traditional models of negotiation have focused almost exclusively on the efficiency properties of both the process and the outcomes (Carraro, Marchiori & Sgobbi, 2005). It can be concluded that “rational” maximizing individual gains was the only or the only predominant in the negotiation process (Albin, 1992). However, Carraro and his colleagues (2005) also pointed out that the considerations other than efficiency play a crucial role in selecting which agreement will be reached – if any at all – and through which path. Albin (1992) mentioned that the fairness plays as an influential factor in many aspects in the actual practice of negotiation. We believe that fairness should be one of the most important factors in the negotiation. But what is fairness?

The research on fairness or justice was originally started from 1960s and was only regarding distributive fairness. Homans (1961) firstly developed the distributive fairness theory. According to his study, distributive fairness is described as following: everyone in an exchange relationship obtains profits which are proportional to the investments. Adams (1965) used a social exchange theory<sup>8</sup> framework to further explain the distributive fairness. He utilized the equity rule to determine the fairness, which is to calculate the ratio of one’s contribution to one’s outcome and then compare the ratio with another one’s. The comparison of the two input-outcome ratios gives Adams' equity theory an "objective" support, but he was clear that this process was completely subjective (J.A. Colquitt et al, 2001). Adams (1965) believed that what people were concerned about was not the absolute level of outcomes per se, but whether those outcomes were fair. Basically, the studies conducted by Homans and Adams built the initial foundation for the justice theory.

In 1975, Thibaut and Walker firstly introduced the procedural fairness and enriched the research on justice. Since then, the study on fairness was extended into two dimensions: distributive fairness and procedural fairness. Thibaut and Walker found that the third-party dispute resolution

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<sup>8</sup> Social behavior was based on exchange. (Homans, 1958)

Social exchange comprises actions contingent on the rewarding reactions of others, which over time provide for mutually and rewarding transactions and relationships. (Cropanzano & Mitchell, 2005)

procedure normally contained a process stage and a decision stage and the disputants own different amount of control in each stage. According to their research, disputants believe that the whole procedure is fair if they keep the control in the process stage. Folger and Cropanzano (1998) think Thibaut and Walker (1975) virtually equated the control in the process stage with procedural fairness. Thibaut and Walker's research was mainly focused on legal contexts, while Leventhal (1980) extended the procedural fairness into non-legal contexts and broadened the contents of procedural fairness far beyond the process control concept. Leventhal (1980) proposed six criteria to determine the procedural fairness: (1) procedures should be consistent across people and across time, (2) self-interests should be prevented and bias should be suppressed, (3) information should be accurate, (4) opportunities should be left for modification or correction, (5) make sure that the opinions of various groups affected by the decision have been considered, and (6) procedures should be compatible with the personal accepted moral and ethical value.

Bies and Moag (1986) introduced the interactional fairness and defined it as the interpersonal treatment people receive when procedures are implemented. However, Greenberg (1993) suggested that the interactional fairness should be seen as two kinds of interpersonal treatment: interpersonal fairness and informational fairness. According to Greenberg's (1993) research, interpersonal fairness are social aspects of distributive justice and can be sought by showing concern for individuals regarding the distributive outcomes they received; while informational fairness are social determinants of procedural justice and may be sought by providing knowledge about procedures that demonstrate regard for people's concerns. Colquitt (2001) further supported that interactional justice should be broken down into its interpersonal and informational justice components, as they too had differential effects. Since then, organizational fairness is best conceptualized as four distinct dimensions: procedural fairness, distributive fairness, interpersonal fairness, and informational fairness.

### **2.3.2 Four types of fairness**

Based on previous research on fairness, Colquitt (2001) generated some items to measure these four types of fairness separately (see Appendix 3). All these items provide us a structural and

dependable framework for measuring fairness, and these variables are used as inspiration for our interview guide in our case study.

### **2.3.3 The application of fairness theory**

The research on fairness initially centered on the fairness among people. Researchers started to integrate fairness concerns with outcomes related to organizations in 1975 (J. A. Colquitt et al, 2001). Organizational fairness is “grown around attempts to describe and explain the role of fairness as a consideration in the workplace” (Greenberg, 1990). Until the late 90’s, the research regarding organizational fairness can be found in the most frequently topics in industrial organizational psychology, human resource management and organizational behavior (Cropanzano & Greenberg, 1997). Konovsky (2000) pointed out that the study of organizational fairness mainly focused on the micro-level such as “individual-individual” relationship and “individual-organization” relationship in the organization, while the research on the macro-level such as inter-firm relationship (“organization-organization”) remained sparse. Fairness theory can be potentially implemented in some macro-level research such as the manner in which resources are allocated within a particular firm as well as between firms (Kim & Mauborgne, 1993). Kim and Mauborgne (1993) firstly utilized the fairness theory to study the relationship between the headquarters and the subsidiaries in the context of strategic management. However, the study based on fairness theory in inter-organization was still scarce. Luo (2005) continued the fairness research on the macro-level and examined the perceptions of fairness in the formation process of strategic alliance. It’s very important to notice that most researchers focused on the operations of strategic alliance by implementing the fairness theory, but Luo (2005) is the first researcher who conducted the study about the formation of strategic alliance by using fairness theory. In Luo’s (2007) research, interactional fairness was still not splitted into interpersonal fairness and informational fairness. Ariño and Ring (2010) used fairness theory to conduct another study on the alliance formation. Differing from Luo (2007), Ariño and Ring (2010) studied the mechanisms between two firms (organization-organization) in the formation phase of alliance from four-dimensions: procedural fairness, distributive fairness, interpersonal fairness, and informational fairness. Following Ariño and Ring’s study, our research also employs the four-dimension fairness theory.

### **2.3.4 The understanding of fairness in negotiation**

Fairness is actually related to negotiation. According to Albin's (1992) study, parties in negotiation usually rely on fairness notions to distinguish between and evaluate alternatives for a solution; to coordinate expectations and forge consensus regarding an agreement; to ensure a stable agreement; and to foster good relations with the other side for future dealings. Albin (1992) admitted that fairness arguments are used as a cover only to couch the pursuit of self-interests at the expense of the other side in many negotiations. However, Albin (1992) also pinpointed that fairness notions influence the "give-and-take" in the bargaining process and help parties forge agreement. As he said, "concepts of fairness may create a motivation to resolve a particular problem through negotiation in the first place, and will have an impact on the positions and the expectations which parties bring to the table" (Albin, 1992). Therefore, the parties involved in the negotiation believe that the longer the influence of fairness lasts, the higher is the possibility for a fair behavior and agreement (Young, 1992).

The failure of negotiations can be caused by many reasons. One reason is that the desire to maximize gains and minimize losses leads individuals to act in ways that prevent mutually beneficial agreements from occurring (Hollander-Blumoff & Tyler, 2008). The preference for gain maximization and loss minimization is related to many cognitive biases, such as a fixed pie bias (Bazerman & Neale, 1983) which may make an individual assume that anything that benefits the other party will hurt him or her. This kind of conflict in negotiations is highly related to the distributive fairness. Fairness research relating to negotiated conflicts focuses mainly on outcome fairness, or distributive justice (Welsh, 2004). However, people care not just about maximizing their outcomes, or even about the distributive justice of their outcomes, but also care independently about the fairness of the process by which those outcomes were obtained (Hollander-Blumoff & Tyler, 2008). Procedural justice has been found to play a large role in assessments of decision making (Tyler & Blader, 2005). The research conducted by Hollander-Blumoff and Tyler (2008) suggested that using fair procedures is one way to move beyond the fixed-pie bias and facilitate the development of integrative bargaining. Thus, we can summarize that fairness play an important role in the negotiation. Carraro (2005) also suggested that it is very important to incorporate fairness in the bargaining theory.

### **2.3.5 Property rights and Control rights**

The study conducted by Sapienza (2000) and his colleagues suggested that the relational processes and procedural fairness of the parties' behavior impact the levels of cooperation between venture capital firm and start-up company. Actually, the allocation of property rights and the control rights in strategic alliance plays an important role during the cooperation. According to Ariño and Ring's (2010) research, the perception of fairness helps to shape the interactions between the property rights and control rights logics of parties, illustrating that the perception of fairness matters to the formation of alliance.

Property rights, simply, is the right possessed by the owner of an asset where the owner has the ability to exclude others from the use of that asset (Hart & Moore, 1990). For a firm in the alliance, the property right is the right to decide how these assets are to be used except to the extent those particular usages have been specified in an initial contract (Hart & Moore, 1990). According to Hart and Moore's (1990) study, control over a physical asset can lead indirectly to control over human assets. Elfenbein and Lerner (2003) furtherly pointed that ownership of the assets confers upon the owning party residual rights of control over the assets. The owner of the assets gains bargaining power from asset ownership that enables him to appropriate a majority of the surplus that results from the project. When allocated efficiently, the incentives provided by ownership will induce the owning party to make decisions that maximize-or come close to maximizing-the returns from the project (Elfenbein & Lerner, 2003). The relationship of the allocation regarding ownership and return is can be related to the distributive fairness.

The allocation of property rights between has been studied by some scholars in different industrial contexts. In biotechnology industry, Aghion and Tirole (1994) suggested that property rights should be allocated to the R&D firm when the marginal impact of its research effort on the value of the final output is greater than the marginal impact of the financing partner's financial investment. In internet industry, (internet alliance), Elfenbein and Lerner (2003) thought the ownership of critical elements such as the website address and the customer data was typically assigned to the party whose effort was most critical to the success of the agreement.



Based on the research conducted by Elfenbein and Lerner (2003), the allocation of control rights appeared most sensitive to the bargaining power of the two contracting parties. If Aghion and Tirole (1994) is followed, the control right can be thought as the relative financial and product-market strength of the two parties. As mentioned above, the party owns huge ownership with its accompanying residual rights of control normally can maximize the gains. However, including some specified control rights in the contract to restrict the control rights granted to the asset owner is still possible (Elfenbein & Lerner, 2003). The specified control rights here can be deemed as the Control rights. In fact, the specified control rights can be different types and are widely utilized in practice. Specified control rights serve a role similar to ownership in the property-right as approach in creating incentives. Empirical analyses of contracting should, therefore, analyze the allocation of specified control rights in addition to ownership (Elfenbein & Lerner, 2003). According to Elfenbein and Lerner's study, It is very important to notice that the control rights are sensitive to relative bargaining power, but ownership is not.

The allocation of the control rights is also considerable important. Lerner and Merges (1998) suggested that the allocation of control rights is a central issue in the negotiation of alliances. In the alliance's proposed governance structure, parties pay attention to both the fairness of the allocation of control rights and the process they negotiate (Ariño & Ring, 2010). This suggests that the procedural fairness relates to the control rights logic. In strategic alliance, venture capitalists often hold extensive control rights over start-up companies, including the right to fire entrepreneurs (Hellmann, 1998). According to hellmann's (1998) research, control rights matter either because they allow one party to make a decision in the presence of conflict of interest or because they affect the threat points in any renegotiation.

In summary, numerous scholars have conducted research on strategic alliances during the past two decades. Some researchers studied the strategic alliances based on the fairness theory. Ariño and Ring (2010) used the fairness theory to research the mechanism between two companies in the formation phase of an international alliance from four-dimension: procedural fairness, distributive fairness, interpersonal fairness, and informational fairness. Others may have only utilized the negotiation theory to explain the process of alliance formation. For example, Pruitt (1983) suggested the Dual Concern Model that negotiators should think about four alternative

strategies to manage conflicts, namely “problem solving”, “contending”, “yielding” and “inaction”. Later, Das and Kumar (2011) suggested another alternative strategy of “compromising” instead of “inaction”, which is more suitable for the situation of negotiation in strategic alliances. Instead of relying on either fairness theory or negotiation theory, both of these two theories are chosen to analyze strategic alliances in the formation phase. Considering the contribution of previous literatures, two main articles from Das and Kumar (2011) and Ariño (2010) are followed to further understand the connection between fairness perception and negotiation strategy implementation in our empirical study.

## 3. Methodology

### 3.1 Research design

In order to provide us with a detailed plan which can guide us through the whole research process and to achieve our research objectives, our research design was chosen in the basis of our research question and accessible resources. There were four stages (see Figure 3.1) in our research, where each stage helped us to set up our milestones.

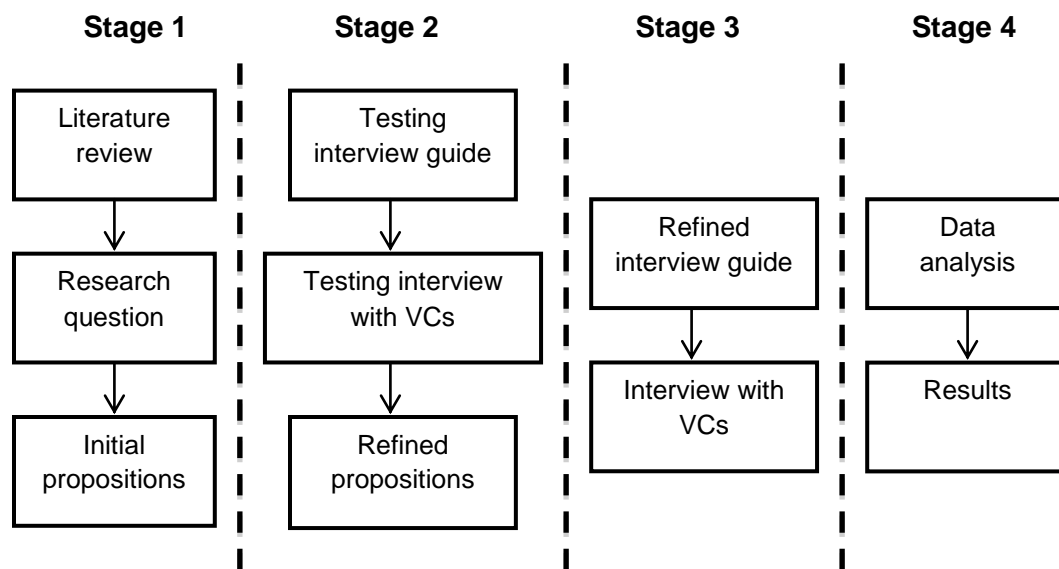


Figure 3. 1 Research procedures

#### 3.1.1 Research question

On the basis of previous literatures, it is considered that negotiation strategy plays a crucial role in the formation of strategic alliances and influences the success of the formation. It is important to notice that the negotiation strategy itself is impacted by many different factors. However, current studies of empirical assessment on the effects of different negotiation strategies in the phase of alliances formation remain sparse. Furthermore, few researchers utilize the fairness theory to analyze the insights of strategic alliances between venture capital firms and start-up companies. All these limitations encourage us to pose our research question as following: *How do perceptions of fairness affect negotiation outcomes during strategic alliance formation between VC firms and start-up companies?*

### **3.1.2 Case study**

Considering the definition of case study - a case study is normally chosen when the research question is “how” or “why”, there is limited control over the events being studied, and those events are contemporary and in a real life context (Yin, 2009). Since our research question is based on the perspective of how fairness perception affects alliance formation in the contemporary society, case study is chosen for our research design to investigate real-life events.

Although some researchers have found the importance of fairness in alliance formations, few found the interactions between fairness and negotiation outcomes of alliance formations. For this reason, this research will try to explain how fairness perceptions will affect negotiation outcomes by using explanatory case studies.

Yin (2003) pointed out that although many kinds of design might lead to successful case studies, but if options are available, multiple-case designs might be preferred over single-case designs on complex subjects. The more cases that can be marshaled to develop a theory, the more robust are the research outcomes (Wilson, 2010). Since it is needed to analyze many cases (initially 10 cases) to support our research, it is well suited for multiple-case case study.

Our choice of case study was designed to allow us to realize what the complete process of negotiation is between venture capitalists and entrepreneurs in the formation phase. The case study also contributed to investigate how venture capitalists, our interviewees, deal with the process of negotiation with entrepreneurs, which helps us to analyze why some factors during the negotiation will affect the final outcome.

Besides choosing case study, in terms of time horizon, cross-sectional design is suitable for our research due to the condition of a very short period of investigating and limited budgets.

### **3.1.3 The choice of case**

The cases studied were all short-term (approximately 5 years) cooperation between venture capital firms and start-up companies in the early stage in IT industry. In addition, only VC firms

located in Oslo were chosen, which helped us to conduct face-to-face interviews. Considering the time limitation, this study would only investigate successful deals, where the VC decided to invest.

### **3.1.4 The unit of analysis**

As one of the major entities of analysis in studies (Wilson, 2010), the unit of analysis in our research is one specific investment case in early stage in IT industry. The participants in our interviews are experienced VCs from different VC firms (one venture capitalist per VC firm) who have many years of work experience in this field. The venture capitalist from each firm presented one specific case he/she had experienced. The answers to the interview questions were also based on the specific case. Much valuable information was gained by talking with VCs and used to analyze how fairness influences strategic alliance formation from the VCs' perspective.

### **3.1.5 The quality of research**

Given that it was very difficult to attain access to ongoing negotiations between venture capitalists and entrepreneurs, the longitudinal design could not be used in this research. Because these cases were not ongoing and some of them occurred several years ago, the interviewees might have forgotten some details. Also, the interviewees were not willing to share the related documents (term sheet and shareholder agreement). Thus, the data was mainly obtained through the communications with the interviewees. This is the main threat to the reliability of this research. However, some principles suggested by Yin (2003) were followed for improving the research reliability.

#### **● Use multiple sources of evidence**

The multiple-case design was used in our case study. It was conducted a total of seven case studies by interviewing seven VCs from different VC firms. The information obtained from these seven different sources supplied us data for the following discussions and conclusion. As Wilson (2010) mentioned, *“any finding or conclusion in a case study is likely to be much more convincing and accurate if it is based on several different sources of information”*. Thus, the multiple-case design can ensure the reliability of our case study to a certain extent.

- **Create a case study database**

The case study data in this thesis includes interview notes, voice recordings and emails of follow up questions. Interview notes were organized immediately after every interview and voice recordings were also transcribed. Then, the structural notes and transcriptions were categorized into the different type of fairness and negotiation strategies. The follow up questions would be sent to the interviewees if any necessary information were missing. The interviewees' replies were also organized and put in the category it belonged to. Then, all these categorized data were further coded. Finally, the case study database was created and ready to be used for our following analysis.

In this research, seven cases were illustrated and analyzed for explaining the influences of fairness in the negotiation in the context of the particular research setting. Some new insights were provided in the study but the findings might not be generalized to other settings. Some methods were used for improving the research validity in this thesis.

- **Internal validity (content)**

In order to improve content validity, both *face* and *sampling validity* were used in this research. For the face validity, the interview guide was sent to the supervisor for review. For the sampling validity, the perceptions of fairness were studied from four aspects: procedural fairness, distributive fairness, interpersonal fairness, and informational fairness. But to examine the entire subject of strategic alliances, the negotiation process was also measured.

- **Internal validity (construct)**

The research question and objectives were changed continuously before the process of literature review. We presented our research question and objectives to our supervisors several times. They helped us to ensure our research question and objectives were comprehensible. According to their suggestions, the research question and objectives were further improved. After several months of discussions, the research question and objectives had become more clear and workable. The interview guide was firstly sent to the supervisors and they provided some suggestions for modifications from an academic aspect. Then, the first two interviews were conducted and used as "pilot" interviews. The questions used in the interview were modified and improved according

to the interviewees' reactions and suggestions. For example, before the interview started, the interview guide was sent to the interviewee for review. During the interview, the interviewee's reactions to each question were noted. After the interview, the interviewee was requested to offer feedbacks on the interview questions, which were used to improve the interview guide.

Note taking and voice recording were the data collection methods in our case study. Note taking was used in the interview for recording the key points, including the conversation contents, interviewee's attitudes and feelings. Voice recording was used to preserve the conversation contents and maintain a high accuracy when transcribing the data. Follow up questions were also used for acquiring more information after the interviews.

## **3.2 Research methods**

### **3.2.1 Research setting**

In order to understand how fairness is perceived between VCs and entrepreneurs, a multiple case study research (Yin, 2003) was conducted. To be able to understand the literature and theories used in this thesis, data to support the literature was needed. As there is no definite answer to how many cases there should be included in a multiple study, however, Rowley (2002) suggests that six to twelve cases might be sufficient to achieve literal replication. Fifteen venture capital firms were contacted to ask if they were willing to participate in our research. Our industry of interest was within IT. Six face-to-face interviews and one telephone interview were conducted. Given the short time period of our research, it had only been feasible to follow up the companies by emails if further questions arise. The VC firms chosen were all situated in Oslo, except one firm which is based in Kristiansand. The reason for contacting this firm was because one of us knew about him from before in a work related matter. In this thesis it is chosen to investigate only successful deals, where the VC decided to invest in the start-up company.

In an ideal setting, a longitudinal study would have been preferred over cross-sectional study where the whole negotiations process could be followed over time, from the very first meeting between the venture capitalist and the entrepreneur until the signing of the deal. The data

collected would be more robust and correct if it was possible to observe both sides during the negotiation. Currently, hearing only one side of the story can leave room for error. But, again, the negotiators present at the meetings may not like outsiders participating and getting insight in every aspect of their negotiation.

Like many case studies, the names of the firms and interviewees in our study are disguised to preserve confidentiality. The cases that were studied were short-term investment at the early stage in IT industry. All the VC firms were firstly screened and then the firms whose portfolio can meet our requirements were selected. The overview of each case has been summarized in Appendix 5. A brief introduction of these firms is illustrated below:

**VC firm 1** was founded in 2001 and have two funds under management. They invest in privately held, early stage technology companies. They have currently 16 active investments in their portfolio and have exited 6 companies. The company is made up of four partners. Our interviewee holds the position as partner.

**VC firm 2** was established in 2001 and manages two funds. They invest within a broad range of technology sectors. Primarily, they invest in early stage companies. Currently, they have 9 active investments and exited 9 companies. The teams consist of three partners. Our interviewee holds the position as partner.

**VC firm 3** was founded in 2006 and is a seed venture fund where they invests in technology start-up companies. They have 10 active investments in their portfolio. The team consists of four employers where our interviewee holds the position as partner.

**VC firm 4** was established in 1996 and invests in early stage technology companies. They have 31 active investments and exited 26 companies. The team is composed of 10 employers where our interviewee holds the position as general partner.

**VC firm 5** was founded in 1889 where they started out within a very different industry before they changed into a venture capital firm in the late 90's. The team consists of 13 employers



where our interviewee holds the position as investment manager. They have 13 active investments in their portfolio. They have exited four companies. They invest in technology and oil/offshore companies.

**VC firm 6** was founded in 1985 and have four funds under management. The majority of investments are in growth stage, but they also invest in early stages within technology, energy, and advanced industry. The company has 11 employees where our interviewee holds the position as partner.

**VC firm 7** was established in 2006 and manages three funds. They invest in seed and early stage companies with focus on technology, energy, and offshore industry. They have currently 11 active investments in their portfolio. The team consists of 8 employees where our interviewee holds the position as partner.

### **3.2.2 Data collection**

The goal of our case study was to understand how the four types of fairness influence the negotiation outcomes in the formation phase of successful strategic alliances from a venture capitalist's perspective. Thus, the negotiation processes between VC firms and start-up companies were invaluable for our research. However, accessing the ongoing strategic negotiation is almost impossible for our study. The main reason was that both VC firms and start-up companies normally would not like to involve non-relative parties in their negotiations for confidential reasons. Though the fact of ongoing negotiations between the VCs and the entrepreneurs cannot be acquired by us, the historical negotiations between them are also valuable for our study. Interviewing VCs was the best method that could be used to obtain these information. According to Crang and Cook's (2007) study, interviewing is a primary method through which ethnographic researchers can get to grips with the contexts of different people's everyday social, cultural, political and economic lives. Simply, *"it's a method of gleaning information from conversations within various research communities"* (Crang & Cook, 2007).

In this research, it was considered that the semi-structured<sup>9</sup> interview was the most suitable. On one hand, we did not want to limit ourselves or the interview by formalizing the interview too much, because it might be possible for us to get new ideas through the interviews. On the other hand, an interview guide is essential since it can help us center on important topics in the limited time perspective. To summarize, by performing semi-structured interview, a framework for what needs to be explored will be established, but this research was open to “a change of direction” and flexible in order to come up with new questions as new information occurs.

A testing question guide was generated (see our question guide in Appendix 4) as the framework for guiding the interviews. These questions were open-ended questions which can provide the interviewees a relative freedom to express their real thoughts. For the convenience of organizing and analyzing interview data, our question guide was designed in correspondence with the fairness and the negotiation strategy. But it was not known if these questions would work well in the practical interview, so the testing interviews were necessary. The question guide was sent in advance to our supervisors for adjusting and improving our interview questions. Therefore, the first two interviews were conducted as trials. Fortunately, good feedbacks and useful suggestions were received from the first two interviewees who helped us to improve our interview questions. Therefore, the quality of the following interviews can be ensured to a certain extent.

Given the short time limitation, it was chosen to angle the cases from only one perspective, respectively, from the VCs point of view. To our advantage, the NVCA (Norwegian Venture Capital Association) website already had an extensive VC firm list available online, therefore the search for VC firms were not as difficult as it was anticipated. Fortunately, several of the VC firms listed on the web page were related to our choice of industry (IT). The rest of the VC firms were obtained by our network and by searching online. The VC firms were contacted and interview request letters were sent electronically to the venture capitalists. Usually, a reply letter would be received around two days after sending out our request letter telling if they would like to accept the interview. For those who didn't reply, a reminder would be sent or phone calls would be made to them directly to check again if they were willing to participate in the interview. In total, interview request letters were sent out to 15 venture VC firms, and finally 7 interviews

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<sup>9</sup> The researcher and participant[s] set some broad parameters to a discussion. (Crang & Cook, 2007)

were obtained. In our request letter, a 45-minute face-to-face interview was requested. In fact, the length of our interviews would range from 30 minutes to 1 hour and 15 minutes. Crang and Cook (2007) pointed out that one hour is long enough, for a single interview to collect sufficient data and to enable the discussion of a range of issues, while being short enough to be “user friendly” for most interviewees. Before starting each interview, the question guide was sent beforehand to the interviewee for review and preparation. The locations of our interviews were mostly at the interviewees’ office for their convenience. It was considered that by conducting the interview in the favor of the interviewee with regard to the place, he or she can keep natural and express the opinions and ideas freely.

The interview mainly concentrated on the negotiation process of one specific successful investment case that the interviewee had done before, but the general personal experience of the interviewee was also welcomed.

During our interviews, voice recording and notes were taken to document the interview data. Taking notes is one of the most important data collection methods and usually used in interviews. According to Clifford’s (1990) study, the notes are taken when engaging in direct conversations about a topic (interview) and write answers down verbatim away from ongoing activities. Besides the note taking, voice recording was another crucial data collection method in our interviews. As Crang and Cook (2007) said, “*voice recording is important because: constantly scribbling down phrases and other notes can be very distracting both for the interviewer and interviewee and may disrupt what could otherwise proceed as a fairly normal conversation; second, the researcher's memory is unlikely to be good enough to remember the intricacies of not only what was said but how it was said and, third, many researchers find it mentally exhausting to listen very closely to everything that their/our interviewees say*”. In addition, all of us took part in every interview because this is helpful for avoiding the interviewers’ personal bias. During the interview, when one of us talked with the interviewee, the other two focused on taking notes for minimizing the loss of important information.

### 3.3 Data analysis and coding procedures

As Silverman and Marvasti (2008) mentioned, “*voice recorded interviews, like texts and audios of naturally occurring interaction, allow you to return to your data in its original form as often as you wish*”. Fortunately, voice recordings were made on several interviews. Thus, our case study raw data consisted of interview notes, voice recordings and emails of follow up questions. All the raw data had to be transcribed before analyzing. Given that the questions in our interview guide were designed based on the fairness and negotiation strategy, the interview notes was easy to organize and classify by the types of fairness and negotiation strategies. “*As with the writing of field notes, the preparation of a transcript from an audio or videotape is a theoretical saturated activity*” (Silverman & Marvasti, 2008). However, transcribing the voice recordings was time consuming. First the voice recordings were listened and those parts of that were relevant to the fairness and negotiation strategy were selected. Then these selected parts were transcribed and transcriptions were organized by the types of fairness and negotiation strategies. Some parts of the recordings that were irrelevant to the fairness and negotiation strategy were also transcribed. Those data helped us to discover new findings. Beside the interview notes and voice recordings, emails of follow up questions were also important for us since they supplemented additional crucial information that was not obtained from our interviews. All these replies were also organized and added into our database. It’s important to notice that all the data generated from our case studies are of high confidentiality.

After the process of transcribing the written notes and audio recordings, collected data were organized into different categories related to fairness and negotiation strategy and coded into keywords which were referred as “coded concepts”. Our data analysis of fairness was performed by following the similar coding procedures used by Colquitt (2001) and Ariño and Ring (2010). And data analysis of negotiation strategy was performed under the definition from Das and Kumar’s (2011) research. As transcribed records make it hard to see patterns and create relations, “*coding fractures the data and rearranges it into categories that facilitate the comparison of data within and between these categories and that aid in the development of theoretical concepts*” (Strauss, 1987). Both the *emergent* and *priori coding* approach (Wilson, 2010) were adopted. Some of the categories were created during the coding and some were created beforehand, based from theories. The combination of these two techniques allows us to “*look for*

*specific set of codes while at the same time provides the flexibility to note any emergent or unforeseen codes”* (Wilson, 2010). Therefore, the method of *open coding* (creating own labels) (Wilson, 2010) was used.

Our transcribed interview data were firstly coded to identify fairness (see detailed procedures in Colquitt’s study (2001) and Ariño’s study (2010)) and negotiation strategy related expressions. Other valuable information in our transcribed data, such as property rights and controls rights related expressions are coded using definition from previous articles; rationality, transparency and BATNA related expressions are new concepts coded by summarizing from our findings.

According to Das and Kumar’ dual concern model (see Chapter 2 of literature review), the basis of concern for one’s own outcomes versus other’s outcomes. Specifically, “concern about both one's own and other party's outcomes encourages a problem-solving strategy; concern about only one's own outcomes encourages contending; concern about only the other party's outcomes encourages yielding” (Pruitt,1983); and “a moderate amount of concern for one’s own outcomes as well as for the other party’s outcomes encourages compromising strategy”( Das & Kumar, 2011). From the first two test interviews, it was difficult for the VCs to elaborate on their negotiation strategies because they did not use any specific “concept” to define their way of negotiation. As one of our interviewees said:

*“It is hard to define what kind of [negotiation] strategies I have been using [...] Well, it might be very easy for you students to find a name in your books, but it is difficult to formulate them [negotiation strategies] in the business world ”*

*Venture capitalist, Case A*

Therefore, it was decided to add an additional question in the last section (see Appendix 4) of our interview guide. In this question, all the four negotiation strategies under academic definition were listed, where they could only choose one alternative which best describes their negotiation approach. From the initial definition, it was difficult for us to understand the difference between problem-solving strategy and compromising strategy, which need to be discussed further.

*Compromising strategy* desires fair balance where both sides appear to get an equitable deal (Pruitt, 1991). Das and Kumar (2011) applied this strategy into firms that are moderately cooperative, flexible, and short-term oriented will pursue this strategy. People using this strategy are seeking to: *optimize their solutions of short-term cooperation, and it is not so significant to have the very best outcomes*. On the other hand, *Problem-solving strategy* is defined as increasing available resources, compensation, exchanging concessions on low priority issues, minimizing the costs of concessions, and creating new mutually beneficial options (Pruitt, 1991). The feature of problem-solving strategy is: *yielding the very best beneficial outcomes and hardly relinquishing their own needs*. By comparing the feature of both two strategies, it is considered that if negotiators chose compromising strategy, they would realize the fact that no one would get everything they want, so negotiators would like to find an equitable arrangement by using alternatives. By contrast, if they chose problem-solving strategy, the negotiators would pursue a suitable way to understand the other side's situation, where they can find a solution that will meet both sides' needs to a great extent without giving up too much about their own needs.

As mentioned earlier (see Chapter 2 of Literature review), *property right* is the right to decide how assets are to be used except to the extent that particular usages have been specified in an initial contract (Hart & Moore, 1990). The ownership of the assets confers upon the owning party residual rights of control over the assets (Elfenbein & Lerner, 2003). Based on the definition of previous research, the amount of investment and the shares of ownership are used to measure the allocation of property rights in the strategic alliance formation. According to Elfenbein and Lerner (2003), it is possible to include some specified *control rights* in the contract to restrict the control rights granted to the asset owner. The specified control rights here can be thought as the control rights. In strategic alliances, it is perceived that the control of board of directors, the right to change the management team and the right of decision-making can be used to measure the allocation of control rights.

Given that a suitable description of *rationality* in previous articles is not found, in this thesis, it is coded as the degree of collecting relevant information comprehensively, thinking consistent to forecasts what might happen in the near future, making the decision that maximizes both parties'

interests, and acting decently that helps to well understand each other. In addition, we try to keep this definition of rationality in our mind, make our conversations very open and summarize our interviewees' opinions when they talk about the negotiation process. Generally, we can only determine rationality through either the emphasizing or ordinary tone used and based on context. The context could be in information collection, disaster forecast, or mutual understanding. Measurements of rationality with questions such as "*to what degree did you collect relevant information?*" and "*to what degree did you think potential possibilities of conflicts or disagreements?*" are adopted.

*Transparency* is the quality of being easy to understand or know about relevant information (Longman, 2009). Ball (2009) found that the definition of transparency reveals three metaphors:

- A. Transparency as a public value embraced by society to counter corruption
- B. Transparency synonymous with open decision-making by governments and nonprofits,
- C. Transparency as a complex tool of good governance in programs, policies, organizations, and nations.

Lamming and his colleagues (2001) believed that transparency may be one of several elements that are built into the specific relationship, along with others such as agreed procedures, equity sharing, joint patents, long-term acquaintance. They also pointed out that wider information sharing can create transparency (Lamming et al., 2001). It is proposed that the effective communication and sensitive information sharing between participants in negotiations can be thought as transparency. Our measurements of transparency have adopted questions such as: do the venture capitalist and the entrepreneur exchange information quickly?

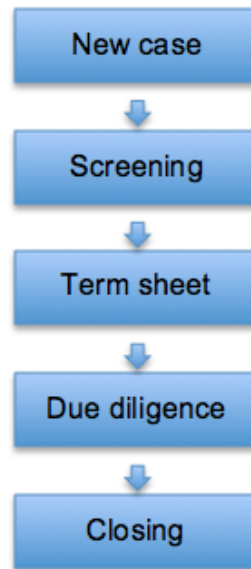
*BATNA* (Best Alternative To a Negotiated Agreement) was introduced by Fisher and Ury (1981) as a tool for negotiators to resolve power imbalances. They did not define what *BATNA* is, but described it as a concept that can help negotiators understand their alternatives in a dispute and help reach agreements that satisfy their interests (Fisher & Ury, 1981). An alternative solution could be, for example, resolving a conflict outside of the process of negotiation and instead in a court procedure (Fisher & Ury, 1981). When negotiators has the option of "choosing" between

two offers (original and alternative offer), the offers can be compared with each other and the negotiators can determine which of them should be considered for acceptance, or if both should be rejected. This alternative solution gives both sides of the negotiation the chance to see things from another perspective and influence them to make better judgments. Also, the negotiators may be more positive to try to negotiate a solution that serves their interests (Fisher & Ury, 1981). The implementation of a BATNA is measured by considering the degree of conflicts and disagreements and what kind of solutions was being employed to solve these conflicts and disagreements.



## 4. Case presentations

Before making a further understanding of our research question: *How do perceptions of fairness affect negotiation outcomes during strategic alliance formation between VC firms and start-up companies?* First the whole process of negotiation between venture capital firms and start-up companies is looked into. From our first two interviews data, the ground for the negotiation process is established. Even though this has been looked into in the literature review, it is better to further see how this was done in Norway and if there were any differences. Therefore, the VCs are asked to lay out their negotiation stages (see Figure 4.1). This is a combined process of the first to VC firms and a short description of each stage is provided:



**Figure 4. 1** Negotiation stages

These stages are almost identical to the investment decision making process, except that most of the VCs (4 out of 7) interviewed said that they performed the term sheet before the due diligence.

During the first stage, the VCs look for new deals in several ways: incoming deals by email, referrals from other VCs or network, or conferences or forum. Normally, nothing is done at this stage except for small talk with the entrepreneur and reading the presentation of the idea. If the VCs is attracted by the case, they will go to the next level, screening. Here, the VCs go through documentations, check the company, and evaluate the technology (often done by external

consultants/advisors). If everything looks good here, then the VCs will present the case to the rest of the team and if everyone approves, then the VCs will go to the next step, term sheet. The most “heavy” negotiation is done here. As understood, this stage takes up to approximately 40-50% of the whole negotiation process. If the terms and conditions are accepted by the VCs and the entrepreneur then the VCs will perform the due diligence. It is necessary to know why some firms performed the due diligence after the term sheet and the explanation was that if the idea/product is very good or/and the start-up company already have an investor then VCs will present the term sheet first to “lock” the start-up company from accepting other offers. But, there have been situations where this has proved to be not effective. Several VCs, that performed the term sheet before the due diligence, have confided in us that they actually came across several critical issues during the due diligence even though the pre-evaluation of the idea/product did not show any problems. The aftermath has two out springs: some VCs decide not to use any more time or money on the case and backs off, others chose to perform a new evaluation and. Those that choose to perform a new evaluation on the start-up company also re-negotiate the term sheet. The last stage is the deal closing, where VCs have the make the decision of investment. Up to this stage, the VCs can back out whenever they like. Nothing is 100% decided or signed.

Since the negotiation processes for both VC firms were very much alike, it was decided not to spend more time on this topic with the other five VC firms during the interviews. Also, this process will not be discussed any further in the case presentations. Given that the main focus is on *one specific negotiation case in each VC firm* interviewed, in the sections that follows, this thesis will elaborate on each case and present the data by focusing on fairness, negotiation strategy and other coded concepts.

## **4.1 Case A**

Case A is the first company interviewed that provided considerably amount of valuable information on the negotiation process between venture capitalists and entrepreneurs. After transcribing the interview data from voice recordings and notes, all these data and coded key concepts are categorized, which will help us to further develop our new theory. The characteristics of the firm are described as following:

**Table 4. 1 Characteristics of Case A**

<b>Fairness Category</b>	<b>Example</b>
<b>Distributive fairness</b>	No big difference between the initial goal and final outcome
<b>Procedural fairness</b>	Presented what the whole process would be to the entrepreneur
<b>Interpersonal fairness</b>	Created trust with the entrepreneur and earned respect from him
<b>Informational fairness</b>	Used all kinds of communications openly and everything needed to be confirmed by documentation
<b>Negotiation Strategy</b>	
<b>Problem solving strategy</b>	High concern for both interests
<b>Coded Concepts</b>	
<b>Property rights</b>	Invested 1 million USD and received 25%-30% shares of ownership
<b>Control rights</b>	Did not change the top management team
<b>Rationality</b>	Prepared well for all the necessary documents; Understood the situation and be reasonable during negotiations

Based on one specific case that the venture capitalist has invested in the field of IT industry, interviews are started by focusing on the whole negotiation process in steps. In the beginning, the venture capitalist and the entrepreneur found each other at a conference where the company held a short presentation about their business idea. During the following four months, one partner was responsible for this case and the negotiation with the entrepreneur.

Considering the topic of *fairness*, it was not asked directly since the concept is difficult to define and explain to the venture capitalist as the interpretation may vary from person to person. Instead, fairness was broken down into four different types, namely *distributive*, *procedural*, *interpersonal*, and *informational* fairness and our measurements of fairness are based on previous framework (see Chapter 2 in Literature review). By analyzing the interview data, it was found that the venture capitalist had touched on all these four types of fairness during the negotiation process, for example, the venture capitalist said that both parties ended up with their

desired amount of shares of ownership at the end of the final investment agreement, which is defined as distributive fairness; *“everything should be written down about the whole ‘scenario’ (possibilities) and explained to the entrepreneur to make the whole process more reasonable”* (Venture capitalist, Case A), which is defined as procedural fairness; by highly emphasizing the importance of respect, trust, and interpersonal relationship the interpersonal fairness is defined; the venture capitalist chose a remarkably open style to communicate with entrepreneur, which is termed as informational fairness.

It is noticed that, it is hard to let the venture capitalist talk about what kind of strategy or formulation he used during the negotiation process. Instead, he answered several open-ended questions related to negotiating skills and factors that were significant to a successful outcome from his standpoint. He shared his experience of *openness* in the first meeting with the entrepreneur, which he described as *“do nothing (research about the company, the person, and the product) before the first formal meeting with the entrepreneur”*. It is considered that this is one of the best ways to decrease personal biases in the beginning. Moreover, once disagreements or conflicts emerge during the negotiation process, the only effective solution is *being reasonable*, which is to understand the situation and find reasons behind the phenomenon. It is very important to notice that both sides should be *rational*, including thinking and acting. Sometimes, entrepreneurs are seemingly emotional about their products, and they do not really understand what the market is and how much risk the venture capitalist has to undertake. According to interviews’ expressions, rationality is coded as by *thinking consistent and forecast what might happen in the near future, making the decisions that maximizes both parties’ interests, and acting decently as to help to understand each other well*. By emphasizing rationality during the negotiation process, it will improve the possibility of maximizing negotiators’ interests and minimizing conflicts or disagreements. A situation where the VCs describe rationality can be easily found. The venture capitalist comments:

*“They [entrepreneurs] are quite emotional when it comes to their ‘babies’, their ideas, their products or services [...], so you have to get it down into something that you can almost create into pages. Then you need to explain to them what the product is, who your potential customers are, or other possibilities [...], and make them understand what we*

*are going to do. We are trying to keep everything rational, not irrational, and we [VCs] try not to get ourselves emotional firstly [...], we try to bring them (disagreements) down to something that can be manageable and discussed. If all of us [entrepreneur and VCs] become emotional or irrational, then we [VCs] walk away because we don't want to work with people who are emotional or irrational"*

*Venture capitalist, Case A*

In our research, the shares of ownership are used to evaluate property rights, and the venture capitalist's decision of changing the management team in the start-up company as determining the venture capitalist's control rights. It is found that the allocation of both property rights and control rights are important issues in the negotiation process.

Considering the issue of organizational conflicts about making the decision of whether to invest in the company or not, an answer as following is obtained:

*"We don't do the investments unless the whole partnership agrees, so there is not like, 'three against one', then, that's no [deal]. So, unless we can agree all the four of us, all the four partners. Then, that will be end"*

*Venture capitalist, Case A*

This is a four – partner investment team, the deal will be invested if and only if all the four members consent to the investment. The principle of this decision-making “strategy” in the VC firm will highly improve the efficiency of negotiation and avoid the internal organizational conflicts.

In addition, the venture capitalist was asked to share one unsuccessful case of his previous investment experience that the start-up company did not access to investment after whole negotiation process. One of the most critical reasons is different views on the valuation of the start-up company, which make it hard to create a mutual understanding between both sides.

According to the venture capitalist's choice of problem-solving negotiation strategy under the academic definition as well as the interview data analysis, it is believed that the venture capitalist has a very high concern for both parties' benefit. In addition, he presented his viewpoint of key factor that affect alliance formation in this case with a great emphasis on the importance of rationality. All these opinions and experience help us to well understand the real-world negotiation process between the VC firm and the start-up company.

## 4.2 Case B

The characteristics of case B are summarized in the following table:

**Table 4. 2 Characteristics of Case B**

<b>Fairness Category</b>	<b>Example</b>
<b>Distributive fairness</b>	Fair chance on a high return for both sides
<b>Procedural fairness</b>	If both parties would like to keep on processing after 3-4 meetings, the following processes would be described.
<b>Interpersonal fairness</b>	Trust and respect were very important.
<b>Informational fairness</b>	Very close communication, high degree of interaction
<b>Negotiation Strategy</b>	
<b>Compromising Strategy</b>	Moderate concern for both parties
<b>Coded Concepts</b>	
<b>Property rights</b>	Not driven by the ownership
<b>Control rights</b>	Options, board control and anti-dilution are crucial
<b>Rationality</b>	Both parties should be rational in the negotiation
<b>Transparency</b>	The worst are lies
<b>BATNA</b>	Established a BATNA. Good deal flow is important

In this case, the venture capitalist firstly outlined the general process of the VC firm. They go through around 200 cases every year and 85% of the cases are submitted by entrepreneurs. Among the 200 cases, about 150 cases are screened but only 15 cases are selected out to perform due diligence. Finally, one or two cases will be invested. The case in question is a start-up

company, where the entrepreneur knew the venture capitalist from 15 years ago in a business related environment. As the venture capitalist said, this was a part of the reason why the case attracted his attention. After the standard screening and due diligence, they entered the term sheet negotiation.

In the negotiation process, the allocation of property rights and control rights is always one of the most important issues. The interviewee thought the ownership was important but not the most important for him.

*“We are not sort of thinking in terms of ownership percentages. There are a lot of parameters such as pricing [of the start-up company], options and board control and so on. And we have to make sure that we believe we can obtain five times return [high return] in several years”*

*Venture capitalist, Case B*

He also mentioned that they indeed had a goal of the ownership and *“it did not move so much”*. Given that there were so many parameters, they could compromise in some aspects: *“one up, one down, try to make both parties feel fair”*. The future negotiation processes were described after understanding the start-up company’s business and growth potential.

*“When both parties want to proceed we typically outline how this process is structured from our side”*

*Venture capitalist, Case B*

It can be concluded that the VC's perception of fairness included both distributive and procedural fairness and influenced the negotiations; he thought about and acted on the principle of fair allocation of both property and control rights

Regarding the interpersonal fairness, the venture capitalist pointed out that the trust and respect is very important. He thought this generally was the foundation of the negotiation. In the case, he knew one of the founders before and they trusted each other to a certain extent. Besides that, the the venture capitalist mentioned that he felt the chemistry between two were quite good. The

early-established personal relationship between the venture capitalist and one of the founders may have contributed to the good start.

The good personal relationship between the venture capitalist and the founder may helped them to communicate more efficiently and share more information. The possibility of exchanging important information was also higher because of their mutual understanding. According to our coded concepts, effective communication and sensitive information sharing between participants in negotiations can be thought as transparency. In other words, the venture capitalist in this case might perceive more informational fairness.

Another important factor mentioned in this case by the venture capitalist was the BATNA (Best Alternative To a Negotiated Agreement). As Fisher and Ury (1981) described, it can help negotiators understand their alternatives in a dispute and help reach agreements that satisfy their interests. In this case, the venture capitalist thought the BATNA was useful. In his opinion, having a BATNA gives the VC firms the benefit to have more options. Because of BATNAs, VCs can have more negotiation space and also increase the possibility of reaching agreement.

At the end of the interview, the venture capitalist was required to select a negotiation strategy to best describe the negotiation process in the case. And the compromising strategy was selected by the interviewee. In the case, the venture capitalist and the entrepreneur listed their concerns about the alliance formation and discussed these concerns together. This process helped them to understand what were more important for the other side. They all gave up some interests and rights in order to achieve the successful formation of alliance. As Pruitt (1991) defined, the compromising strategy “*desires fair balance where both sides appear to get an equitable deal*”.

Regarding the unsuccessful case, the worst scenario for the venture capitalist is entrepreneurs hiding unfavorable information which is considered as lies. In the failed case the venture capitalist experienced, the negotiation process was smooth at the early stage. But after several meetings, the venture capitalist discovered that the start-up company was in a different situation than they claimed to be. The venture capitalist felt that the entrepreneur hid some things about the start-up company. Thus, the venture capitalist decided to leave the negotiation. From this



case, it can be seen that the trust and the transparency were thought as very essential factors by the venture capitalist.

### 4.3 Case C

The characteristics of case C is summarized in the following table:

**Table 4. 3 Characteristics of Case C**

<b>Fairness Category</b>	<b>Example</b>
<b>Distributive fairness</b>	Invested less than planned, received less ownership than proposed, but had a second investor involved
<b>Procedural fairness</b>	Explained the mission and expectations
<b>Interpersonal fairness</b>	Respect, trust, faith and chemistry were crucial
<b>Informational fairness</b>	Effective communication, all documents were available
<b>Negotiation Strategy</b>	
<b>Problem solving strategy</b>	High concern for both parties
<b>Coded Concepts</b>	
<b>Property rights</b>	Fair allocation of ownership
<b>Control rights</b>	Be willing to change the team
<b>Rationality</b>	If the arguments seemed rational, the venture capitalist would accept
<b>Transparency</b>	Be open upfront

In this case, the venture capitalist first heard of the start-up company when the founder contacted the VC firm by email. From the first contact to the signing of the deal, it took approximately 5 months. During these 5 months, two-way communication went smoothly and going at a steady speed and where all the necessary documents were provided by the entrepreneur, all aspects of informational fairness. The venture capitalist pointed out that it was important that both parties were open at the very first meeting to establish trust. Therefore, soon after the venture capitalist received the proposal and decided to go further with the entrepreneur, she laid out their expectations and mission in this deal. These actions indicate that the venture capitalist views transparency as an important factor to build trust and that she practiced procedural fairness.

When experiencing disagreements and conflicts, the venture capitalist commented that they “*spend a lot of time on talking and discussing to build trust*”, which is a matter of interpersonal fairness. The venture capitalist explained that most of the disagreements aroused during the negotiation of terms and conditions in the term sheet. Because many entrepreneurs are unfamiliar with how the venture capital industry works, they have a subjective standpoint when negotiating with VCs. The venture capitalist said that they explained why they needed these proposed terms and “*changed the way of communication when the entrepreneur didn’t agree/understand*”. The venture capitalist explained that it was important that they “*convinced each other that they were a match*” when both parties were mutually interested in a successful outcome even though there were conflicts. For example, when the venture capitalist exercised control rights by proposing that the management team needed a modification because it was not competent enough, it was not well received by the entrepreneur. The venture capitalist expressed that she believed that this will benefit the daily operation of the start-up company and implied that a change in the management team was the best solution to achieve this. They managed to come to terms with each other and the team was changed. The venture capitalist concluded that it was important to stay *rational* in any kind of conflict:

*“if the arguments seems rational, then we will accept it”*

*Venture capitalist, Case C*

Initially, Firm 3 was the only investor involved in the negotiation. The size of the *property rights* and the size of investment were already confirmed by both parties, but the deal was not signed yet. At the last minute, another VCs (an acquaintance of the VC firm) entered the negotiation and jointly invested in the start-up company. In the light of this last involvement and in terms of distributive fairness, the venture capitalist invested less money than they initially had planned, and the ownership shares were diluted. The venture capitalist of Case C was contended with the final result because they had an external investor that not only contributed with money, but also acted as the start-up company’s CTO and did the technical evaluation of the start-up company during the due diligence.

The venture capitalist pointed out that the reason they decided to invest was mainly because of two criteria: mutual trust and faith, and that the people were right (the venture capitalist liked the founder). Another important criterion, which the venture capitalist noticed from early on is, chemistry. First and foremost, they have to like each other to be able to cooperate. Second, they need to be on the same page, for example, when discussing the business model. And lastly, they need to have common goals.

The venture capitalist chose the problem-solving strategy as the strategy that most closely resembles the way she negotiates. She explained that she cared about both parties obtaining their desired interests.

Negotiations that failed and resulted in unsuccessful outcomes were mostly due to the incompetence of the founder or management team. Other problems were disagreements about the pricing and capital requirements. The venture capitalist explained that too much was at stake if she considered investing in a start-up company that had these kinds of problems.

## 4.4 Case D

The characteristics of case D is summarized in the following table:

**Table 4. 4 Characteristics of Case D**

<b>Fairness Category</b>	<b>Example</b>
<b>Distributive fairness</b>	Received less ownership than intended to obtain
<b>Procedural fairness</b>	Did not tell the start-up company the future negotiation processes
<b>Interpersonal fairness</b>	Both parties trusted each other upfront
<b>Informational fairness</b>	Quick responses and clear feedbacks
<b>Negotiation Strategy</b>	
<b>Contending strategy</b>	High concern for own interests
<b>Coded Concepts</b>	
<b>Property rights</b>	The allocation of ownership was fair
<b>Control rights</b>	Changed the management team
<b>Rationality</b>	Arguments should be supported by the facts and reasons
<b>Transparency</b>	Be straight and honest from the beginning

In this case, the venture capitalist had been “monitoring” the start-up company for some time before they decided to arrange a meeting. They conducted an initial investigation on this start-up company in terms of technology, market and other related aspects. They concluded that the start-up company was overall suitable for their investment profile. However, after several meetings, the venture capitalist noticed that the strategic abilities of the management team were not as good as they thought and they also learned that the team did not have enough capabilities to develop the start-up company rapidly. Besides that, both parties had very different opinions on the valuation. Thus, they (the venture capitalist) decided not to enter the formation phase of the strategic alliance. Around one year later, the start-up company launched its new product but the product did not penetrate the market, which resulted in capital shortage. This created the second opportunity for both parties to start a new negotiation for the strategic alliance.

After investigating and analyzing the start-up company, the VC firm understood the capital needs of the start-up company and proposed the desired amount of investment to the entrepreneur which he accepted. Given that the capital size of the investment was fixed, the ownership became one of the main issues for both sides. The VC firm intended to obtain more than 30% ownership of the start-up company, but finally reached an agreement on less than 30%. As the venture capitalist perceived, the entrepreneur cared deeply about the ownership shares and to reach an agreement, the venture capitalist compromised and decreased the number of shares to below 30%. But the amount of shares was still above the bottom limit for the VC firm. The VC thought the allocation of ownership was very fair for both parties. In aspects of fairness, these actions reflect that distributive fairness was very obvious and which lead to a fair allocation of property rights.

In addition to the property rights, the control rights were also very important in this case. The venture capitalist was dissatisfied with the management team and insisted to modify it. The result was that the entrepreneur accepted the modification and half of the management team including the CEO were changed. Besides that, the venture capitalist also designed a new development strategy for the start-up company. Based on the actions above, the venture capitalist exercised a high level of control power and the allocation of control rights was not fair.

In terms of interpersonal fairness, the venture capitalist mentioned that the both parties should trust each other from the beginning. As he said: *“If there is no basic trust at the beginning, it is really unnecessary to keep on the following negotiation”*. They brought all concerns to the table and discussed and analyzed these issues one by one. They were very rational in the negotiation because they usually used facts and figures to support their arguments (rationality). Regarding the informational fairness, the VC very satisfied with the quality of the communications between two firms and he thought the two sides were always very straight and open for each other in the whole negotiation process (transparency). He always received replies quickly and the feedbacks were very clear. He also responded to the start-up company’s questions quickly and explained every issue clearly. Therefore, the interpersonal fairness and the informational fairness indeed influenced the negotiation to a certain extent.

Even though the influence of the fairness (especially the distributive fairness) is seen in the case, the venture capitalist still emphasized: “*I definitely concern more on our interests than on their interests*”. He finally chose the contending strategy which cannot lead to the successful formation theoretically. However, it is important to understand the reason behind the choice in the case. The start-up company was in an emergency situation and were in urgent needs of capital needs. For the start-up company, the most important thing was to get enough capital to maintain the operation. Unfortunately, many investors lost substantial sums of money on the dot-com bubble<sup>10</sup> in the early 2000s. Venture capital firms were more careful when considering to invest in internet based companies during that period of time. Therefore, for the start-up company in this case, it was difficult to acquire investment since this was during the dot-com bubble, which led to a weaker bargain power for the start-up company. For the VC firm, protecting their interests and minimizing the risk was the most essential factors when investing in internet based companies during this period, creating a stronger bargaining position. This can explain why the contending strategy worked in this case.

Our interviewee shared his experience of unsuccessful cases, he pointed out that the valuation was the main “killer” in for the successful formation of the strategic alliance. In his previous experience, many entrepreneurs overly valued their start-up companies, which lead that it was so difficult to agree on the amount of investment and the shares of ownership (property rights in our study). Thus, it is considered that the allocation of the property rights had influence on the successful formation.

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<sup>10</sup>The dot-com bubble was a stock market bubble which popped to near-devastating effects in 2001.

## 4.5 Case E

The characteristics of case E is summarized in the following table:

**Table 4. 5 Characteristics of Case E**

<b>Fairness Category</b>	<b>Example</b>
Distributive fairness	Amount of ownership shares given was equal to the intended amount
Procedural fairness	Future processes were explained to the entrepreneur
Interpersonal fairness	Chemistry and trust are most important factors
Informational fairness	Communication was fast and good
<b>Negotiation Strategy</b>	
Problem solving strategy	High concern for both parties
<b>Coded Concepts</b>	
Property rights	Invested 10 MNOK, received 40-45% ownership shares
Rationality	The venture capitalist needed proof of what the entrepreneur said
Transparency	Openness was essential

In this case, the venture capitalist and the entrepreneur met at the Connect Forum where the entrepreneur gave a presentation about his idea. After the presentation, the venture capitalist and the entrepreneur met for discussion and the venture capitalist liked the idea and the entrepreneur. Therefore, the venture capitalist decided to proceed further with this case.

At the time of the first meeting at the conference, the product was still under development. The whole negotiation process took approximately 6 weeks, which is the fastest case in our research. Because this was only an idea, and the product was still under development and there were no other interested parties involved, the venture capitalist performed the due diligence before the term sheet. They wanted to understand the business model, the idea and the capital needs – the total value based on the idea. Since the venture capitalist believed in the idea and the entrepreneur, they proceeded to the term sheet negotiation.

In terms of the *property rights*, the venture capitalist comments: *“We pretty much got what we wanted. You make up your mind about what you roughly want, right [...], but of course, it also depends in the investment size”*.

The entrepreneur was “generous” and was willing to give away half (50-55%) of the company to the venture capitalist, but the venture capitalist was not positive to the suggestion:

*“We want the founder to hold a significantly stake in the company [...]. It’s the motivation, he has to think ‘oh, it is still my company and I’m not working for the VC firm’, then he will just be an employee. Especially as an entrepreneur, you are driven because you want to build something [...]. You want him to succeed”*

*Venture capitalist, Case E*

The venture capitalist had set out for a high ownership share, higher what he usually would demand because of the risks that bored with the investment of an unfinished product and the capital requirement proposed by the entrepreneur. The venture capitalist decided to settle for the amount of shares he initially intended for, which was below the amount proposed by the entrepreneur, but he received the capital he needed (distributive fairness).

The venture capitalist expressed that the most important factors for determining whether to invest or not, lies in the belief in the idea, the team, trust, openness and the “gut” feeling. He explains that it is not so much about the idea itself, but that there is belief in the idea and that the team is competent enough to actually *execute* the idea. The venture capitalist emphasizes that both parties have to be able to trust each other and have certain chemistry (a matter of interpersonal fairness), and be open towards one another. Also, he emphasizes that it is important that the he can trust what the entrepreneur says and provide proof for what he has said (rationality).

Given the short time spectra of the negotiation, the venture capitalist described the two-way communication quality as good and timely feedbacks was provided by both parties. In terms of



procedural fairness, the venture capitalist informs the entrepreneur about the way they operate and explains the next steps in the process.

The venture capitalist concluded the interviewee by choosing the problem-solving strategy, which he explained as the importance to consider both parties' interests and needs.

The negotiations that failed to result in a successful alliance were due to the lack of belief in the idea or product or internal issues within the VC firm.

## 4.6 Case F

The majority of this firm's investments are in growth stage, but they also invest in early stages within the industry of advanced technology. With the strict cooperation agreement between the venture capital firm and the invested firm, it was not possible to gain too much access to some detailed information about this case, e.g., shares of ownership. The coded frame is showed in Table 4.6.

**Table 4. 6 Characteristics of Case F**

<b>Fairness Category</b>	<b>Example</b>
Distributive fairness	No big difference between the initial goal and final outcome
Procedural fairness	Explained negotiation procedures to the entrepreneur and made him/her open
Interpersonal fairness	The investment was about trust;
Informational fairness	Communication within timeline
<b>Negotiation Strategy</b>	
Compromising strategy	Moderate concern for both parties
<b>Coded Concepts</b>	
Transparency	Openness was important during the negotiation process; Mutual understanding

In this case, during the six-month negotiation period, the VCs were focusing on the importance of cooperation and the necessity of making a concession to better solutions when disagreements emerged. For this reason, he defined to use compromising strategy. He pointed that every negotiation was starting at the understanding of the company, including its financial situation,

customers, and business model. The following steps, such as setting up term sheet and proceeding due diligence, were based on mutual understanding of each other. Besides that, the management team in the company was very important as well. In addition, he was emphasizing on the crucial role that openness played when negotiating, which was coded as *transparency*. He comments as follows:

*“You need to put everything very clear in the beginning, how we are thinking, how our process [negotiation process] is. That is a good first step. Then you need to transcribe them to the other side [...]. You should always keep in mind that what both sides think and how you behave [...]. Being transparent, transparent, transparent”*

*Venture Capitalist, Case F*

Based on our question guide, the venture capitalist agreed the viewpoint of the importance of trust which he believed that it is always the key in every business. But the method of building trust is very tailor-made. The question of how to establish trust in a very limited period is to be discussed further in future research.

However, it was not possible to get too much information about neither the amount of investment nor shares of ownership, which constrain our understanding of how property rights work in the negotiation process.

When talking about unsuccessful negotiation cases, the answers are quite clear, which is:

*“Things [this business] appears not to be true in our due diligence report, and the seller understood the withdrawal of offer [...].”*

*Venture capitalist, Case F*

## 4.7 Case G

The characteristics of case G is summarized in the following table:

**Table 4. 7 Characteristics of Case G**

<b>Fairness Category</b>	<b>Example</b>
Distributive fairness	High ownership shares, low investment, but during bad times; The received amount of shares was not far from the amount proposed by the entrepreneur
Procedural fairness	Provided a time schedule
Interpersonal fairness	Trust and respect were important
Informational fairness	Good response time, effective, all documents available
<b>Negotiation Strategy</b>	
Problem solving strategy	High concern for both parties
<b>Coded Concepts</b>	
Property rights	Received 38% shares of ownership
Control rights	Changed 2/3 of the management team

In this case, the entrepreneur found Firm 7 through his network and contacted them by telephone. This case differs from the other cases in that the start-up company was running out of cash at the time of the negotiation. The entire negotiation process took approximately 1 year. The reason for the long negotiation time was that Firm 7, who holds two funds under management (one for early stage start-ups and one for middle stage companies) assessed the company as a middle stage company. But later, as negotiation went by and they agreed on the term sheet, and the venture capitalist performed a due diligence, they discovered that the company had product development issues, which was also the reason why they needed more money, and concluded that the company was too “early stage” to be assessed as a middle stage company. According to the venture capitalist, the development process was slower than anticipated, almost reaching a critical point. A new evaluation was performed on the company and the terms and conditions on the term sheet were changes.

The venture capitalist settled for a higher ownership share (property rights) than what they first proposed and a little higher than what the entrepreneur was willing to give due to the problems discovered during the due diligence and that the venture capitalist had to consider the risks of investing in a company in this condition. Therefore, the proposed investment was low, lower than what the entrepreneur expected. With these facts, the venture capitalist felt that this was an appropriate offer (distributive fairness). But, given the fact that the start-up company was *“running out of money and didn’t have any other alternatives”* (Venture capitalist, Case G) and that this was in 2008, during the financial crisis, the start-up company settled for the proposed offer. In addition, the venture capitalist also used his control rights to change 2/3 of the team in close cooperation with the founder.

During the first negotiation, a brief time schedule was presented by the venture capitalist about the upcoming events. It was important for the venture capitalist to understand the company, the business model and whether they wanted to go further or not, which they did. The beginning was less structured, but the later stages were more defined. These actions indicate procedural fairness. The venture capitalist pointed out that the communication between the two parties was very efficient and had a very good response time (informational fairness). Also, the entrepreneur provided him with all the material that he needed.

The venture capitalist concluded that the most important factors for investing were that the people/team was right, mutual trust and respect (interpersonal fairness), and that they were able to build the company and create value for the company. If these facts are missing, then, according to the venture capitalist, he will not invest. The venture capitalist believed he used the problem-solving strategy during the negotiations because he was equally concerned about both parties’ outcomes.

## 5. Discussion of findings

In order to extend our understanding of previous literature based on negotiation theory and fairness theory, these two main theories are used to analyze the empirical data collected on the successful strategic alliance formation cases. The proceeding chapter examines how negotiation strategies explain the preceding seven cases. The proposed framework will illustrate the connection between fairness perception and negotiation outcomes. Leading to propositions based on the findings from the aforementioned analysis.

### 5.1 Implementation of prior literatures

From the interview data, it was discovered that most of the interviewees chose problem-solving strategy (four out of seven), two interviewees chose compromising strategy, and one chose contending strategy. It is obvious to understand venture capitalists' choices of problem-solving and compromising strategy by the reason that every deal needs to be fair in VCs' opinions, or referred as: "*equal concern for both parties' interests*". The differences between compromising strategy and problem-solving strategy are discussed respectively in the next sections.

*Compromising strategy*, firms that are moderately cooperative, flexible, and short-term oriented will pursue this strategy (Das & Kumar, 2011). The compromising strategy seeks some fair balance where both parties appear to get an equitable deal (Pruitt, 1991). People using this strategy are seeking to: *optimize their solutions of short-term cooperation, and it is not so significant to have the very best outcomes*. It also means that both parties, to a great extent, need to make sacrifices. Such an interpretation indicates a compromising strategy can hardly avoid potential conflicts arising from not solving all the problems. As Das and Kumar (2011) said: "Choosing compromising strategy in the formation phase will not achieve an integrative outcome". During the negotiation process, negotiators who use compromising strategy tend to see the other party as worthy and equal to themselves. Therefore, the negotiators are looking for a fair process and outcome. Negotiators employing compromising strategy realize no one will get everything desired. So, negotiators can pursue an equitable arrangement through the use of alternatives. On the other hand, it is also noticed that those venture capitalists that chose

compromising strategy during the negotiation process always held a very high opinion or mutual respect and trust of the other party.

*Problem-solving strategy* is defined as increasing available resources, compensation, exchanging concessions on low priority issues, minimizing the costs of concessions, and creating new mutually beneficial options (Pruitt, 1991). The feature of problem-solving strategy is: *yielding the very best beneficial outcomes and hardly relinquishing their own needs*. The problem-solving strategy is suitable for the situation where both parties pursue the high integrative potential and long-term cooperation with high aspirations (Pruitt, 1991).

The problem-solving strategy is similar to the compromising strategy in many ways. Venture capitalists choosing this strategy expressed that he or she does not treat the other party as a competitor, but rather as a potential cooperation partner who has legitimate requirements. On one hand, the negotiators are looking for reasonable solutions that can make them work together over a very long term. On the other hand, the negotiators pursue a suitable way to understand the other side's situation, where he or she can find a solution that will meet both sides' needs to a great extent.

From this viewpoint, it is considered that most venture capitalists prefer making the choice of applying problem-solving strategy in the negotiation process for the reason of pursuing beneficial outcomes without losing too much of their needs and rights. From another standpoint, some people may choose compromising strategy with equitable arrangement by using alternatives. Although one interviewee chose a contending strategy during the negotiation process, it is found that internet based firms had little leverage in investment negotiations during 2000 the dot-com bubble burst. In the background of this business cycle, it is understandable VCs' hesitation make investments in start-up companies. From the VCs' perspective, protecting their interests by minimizing risk exposure became the most crucial factors when investing in internet based companies during this period. Compared with the other six cases, this case was an exceptional one.

Das and Kumar (2011) argued that negotiators may employ different negotiation strategies which will influence the negotiation outcome (deal/no deal) in the phase of alliance formation. Specifically, a problem-solving strategy will lead to a successful strategic alliance formation by developing mutual trust or strengthening pre-existing relationships; a contending strategy will not make a successful strategic alliance formation; neither a yielding strategy nor a compromising strategy will achieve an integrative outcome (Das & Kumar, 2011). Das and Kumar's study is considered as one of the most remarkable references in this research by laying a theoretical foundation to build on. In order to better understand the implications of problem-solving and compromising strategy, the seven VC cases will be analyzed further during the following paragraphs.

From the interview data, it is considered that the property rights concern mutual financial benefits between the venture capital firms and start-up companies. Meanwhile, a problem-solving strategy emphasizes creating new mutually beneficial options by yielding the very best outcomes and hardly giving up their own needs. Therefore, the conflicts arising from the allocation of property rights can be effectively solved by using problem-solving strategy. For example, Case E implies that venture capitalists always have an idea of how much ownership shares they want in accordance with the investment size, but at the same time it is important that the entrepreneur himself holds a certain amount of property rights in his own company so that he knows (the entrepreneur) that he still owns the company and maintains the motivation of building the company to prosper. It is concluded that in a situation where both parties pay attention to each other's needs, the two sides likely to choose the problem-solving strategy that can help strengthen the relationship and contribute to a positive outcome (Tjosvold et al.,1999).

On one hand, the VCs and entrepreneurs had a mutual understanding which made them understand each other's real concerns. On the other hand, the high degree of trust would make VCs and entrepreneurs more willing to give up something. As the venture capitalist in Case B mentioned: "*give up something which is not so important to us but very crucial to the entrepreneurs*". By applying this kind of strategy of compromising, many conflicts can be avoided in the negotiation and VCs and entrepreneurs can try to achieve a balance agreement. In the light of these findings, it is proposed that if the relationship between the venture capitalist

and the entrepreneur is strong, then the venture capitalist may use a compromising strategy, as a compromising strategy has been found to be high on relational appropriateness (Gross & Guerrero, 2000).

Considering Pruitt's (1991) research, compromising strategy desires fair balance where both sides appear to get an equitable deal. In Euwema's (2003) study, compromising strategy is expected to enhance relational satisfaction which helps to achieve both sides' interests. The VCs and entrepreneurs with mutual trust and understanding would like to select this strategy for avoiding conflicts and look for an equitable solution for both sides, leading to a successful alliance between the VC firm and the start-up company. Based on Das and Kumar's (2011) research, companies that are moderately cooperative, moderately flexible, and short-term oriented will pursue this strategy. Even though this strategy cannot lead to achieving an integrative outcome (Das & Kumar, 2011), that is, negotiating parties may be willing to make concessions but may resist doing the same on issues that are important to them (Das & Kumar, 2011), it can still result in a successful outcome. Most strategic alliances are short-term and the cooperation of the VC firm and the start-up company is usually flexible. Thus, compromising strategy could be an effective strategy in the strategic alliance negotiations and can lead to a successful formation. The two cases from Case B and Case F showed as much.

By examining previous articles about these theoretical negotiation strategies in a real-world context, the significant effect of problem-solving strategy that will lead both sides to make an agreement of investment in alliance formation phase has been successfully proven; the findings from the seven cases indicates that compromising strategy based on mutual trust or transparent information sharing will also lead to a successful alliance in the formation phase, which has empirically complemented the due concern framework to some extent. In addition, not too much information is found about contending and yielding strategy in this study.

## **5.2 New findings based on fairness theory**

Venture capitalists may hold extensive *control rights*, including the right of decision-making and even the right to change the top management team in the start-up company (Hellmann, 1998).



Mostly, the issue of control rights focuses on the top management team. Venture capitalists might argue that excellent a top management team will add value to the company, while founders or entrepreneurs tend to employ management team in their personal interest or attachment as opposed to the interest of the company (Hellmann, 1998). The typical venture capital deal includes the shareholder agreement and the employment agreement (Testa, 1997; Timmons, 1999). The *property rights* approach takes the point of view that the possession of control rights is crucial for the integration decision (Hart & Moore, 1990). That is, if the venture capital firm wants to acquire part of the entrepreneurial firm's profit stream, it can always do this by contract.

The shareholder agreement specifies the allocation of shares held by the entrepreneur, management team, and investors. The percentage of ownership given to each party depends on the particular situation of the start-up company. There is no specific answer of how much ownership the company has to share in order to get the investment. According to our interview data, the ownership percentage acquired by venture capital firms varies from 20% to 50%. As perceived from the interviews, the greater the potential return perceived by VCs, the less ownership they may require. It is also important to note that some VCs pay more attention to the entrepreneurial team per se than the innovative idea. Even though the business idea may be good – the marketable product has great potential to seize the consumer market – the idea may still be duplicated by others. However, an entrepreneurial team with ability, wisdom and good chemistry is extremely difficult to replicate. Although many researchers only emphasize the importance of the product itself, it is considered that the team is even more significant in practice. One of our interviewees' comments reveals as much:

*“There are hundreds of companies that contact us every year. We need to screen these companies and can only invest in 1% or 2% of them. One of the most important reasons that attract our attention is the capability of the team. We have to like the team. We know that no matter how great the idea is, it will be copied somehow, or maybe someone else has the same idea. But the team, people, cannot be copied. So, I believe the team is most valuable for us”*

*Venture capitalist, Case E*

Some venture capitalists express that they expect the top management team to operate their business without interference from investors. However, there are many VCs that state that they will participate in the daily operation of the invested company through the board of directors. For this reason, VCs usually acquire a seat on the board of directors during the negotiations, which may affect the future operations of the company. For instance, making the decision of changing the management team, some investors said that they may change the management team if he or she does not qualify for the held position in the company. One investor commented:

*“It is inevitable that some people [management team members] cannot make a difference to the business, well, they might be excellent in other fields but not in this position where we do our business. If so, we have to make our [VCs] decision of changing the team and find someone else qualified”*

*Venture capitalist, Case C*

We are motivated by *Rationality* in our case study of analyzing negotiation process between VC firms and start-up companies. Rationality might be first defined in Simon’s bounded rationality theory, which is a concept traditionally used in the field of negotiation (De Carlo, 2011). In this theory, negotiators’ cognitive and computational capacities are limited by outside constraints, especially in the rich information environment (De Carlo, 2011). For this reason, they may only choose satisfactory decisions and ignore exploring other better solutions. Some other researchers, like Tsay and Bazerman (2009), define rationality as lying outside the negotiators as human beings. Negotiators not only process the information by interpreting the negotiation situation, but also use cognitive processes effectively and limit biases as far as possible. Emotion must be controlled or avoided, for it will disrupt negotiators’ cognitive process (Fisher & Shapiro, 2006).

Although it is difficult to apply the rationality theories from prior articles in this research, the theories help to better understand the concept of rationality to some extent. Thus, rationality in this study is perceived to be thinking consistent and forecast what might happen in the near future, making the decisions that maximizes both parties’ interests, and acting decently to help understand each other thoroughly. By emphasizing rationality during the negotiation process, it

will improve the possibility of maximizing negotiators' interests and minimizing conflicts or disagreements.

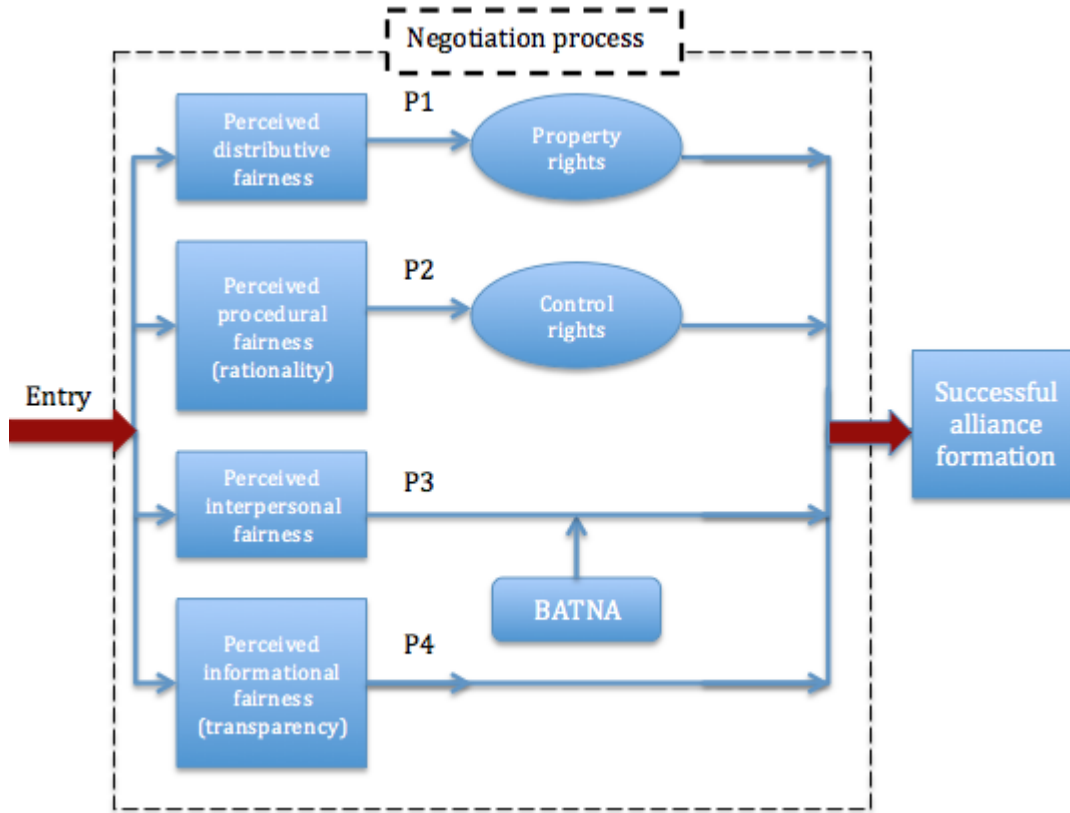
In the interviews, some interviewees in our study mentioned the term transparency. For example, the interviewee in Case C thought VCs and entrepreneurs should be open with each other from the beginning. The interviewee in Case D also holds the same opinion. The interviewee in Case F further pointed out that openness can lead to better mutual understanding in negotiations. Thus, transparency became one of our coded concepts. As Lamming mentioned (2006), wider information sharing can create *transparency*. So transparency is related to the informational fairness. Based on the previous research, transparency meant the effective communication and sensitive information sharing between VCs and entrepreneurs. Measurements for transparency are developed with questions such as:

- Do the VC and the entrepreneur exchange information quickly?
- Is the communication between the venture capitalist and the entrepreneur intensive?
- To what extent are they acting openness towards each other?
- Do they disclosure sensitive information of their firms to each other?

Fisher and Ury (1981) introduced BATNA (Best Alternative To a Negotiated Agreement) as a tool for negotiators to help them understand their alternatives in a dispute and help reach agreements that satisfy their interests (Fisher & Ury, 1981). From the interviews, it is found that BATNA was useful to negotiate alternative solutions to resolve disagreements in a situation where the venture capitalist and the entrepreneur had a good relationship and a high perception of interpersonal fairness. Especially, when other aspects of the deal (business idea and team) seems reasonable, agreeable, and they (the venture capitalist and the entrepreneur) are hesitant with leaving the deal. Venture capitalists and entrepreneurs will turn to BATNA to rethink their interests and arguments, recognize their alternatives, which gives both parties a second chance to negotiate instead of walking away from the deal. This works both ways. It gives the opportunity to look at two different proposals and be able to compare them with each other. This allows both the venture capitalist and the entrepreneur to see things from another perspective - it can give them a "fresh start" on the negotiation and influence the final outcome.

Colquitt (2001) clearly defined the four types of *fairness*: procedural fairness, distributive fairness, interpersonal fairness, and informational fairness. He also developed a set of items to measure the four kinds of fairness, and the measurements he created became the foundation of the interview guide. Ariño and Ring (2010) also used the definition of fairness from Colquitt (2001) to conduct the research for their paper *the role of fairness in the alliance formation*. Their research showed the application of fairness in the alliance context, which also influenced the formulation of our research question. Their findings of the relationship between distributive fairness and property rights and the relationship between procedural fairness and control rights were also utilized in our study.

It is noticed that each interviewee has perceived the four types of fairness, more or less, during their negotiation process with the start-up companies. Thus, it is believed that once a venture capitalist enters a negotiation process, he or she will perceive distributive, procedural, interpersonal, and informational fairness. The only difference for the VCs is the different extents of perceived fairness. For instance, some VCs may emphasize distributive fairness, while others might pay attention to interpersonal fairness. It is proposed in this thesis that the extent of fairness perception with the four types of fairness by the venture capitalist may affect the final outcome of the negotiation in the strategic alliance formation. However, the interactions between different types of fairness and negotiation outcome of successful alliance formation are not only determined by the perception of fairness itself, but also involve other *variables*. Thus, it is suggested that *property rights* and *control rights* play a significant role of connecting fairness perception and successful negotiation; *BATNA*, on the other hand, has a positive moderating effect on fairness perception to an agreement. The findings of this study have been framed in Figure 5.1, and our research propositions will be discussed further in the following section



**Figure 5. 1 The perceptions of fairness in alliance formation framework**

### 5.3 Research propositions

During the negotiation process between a venture capital firm and a start-up company, both sides have concerns over property rights. Property rights are defined as the right possessed by the owner of an asset where the owner has the ability to exclude others from the use of that asset (Hart & Moore, 1990), and that control over an asset can lead indirectly to control over human assets. Our findings shows that property rights (measured as ownership shares) are one of the most important factors in an alliance formation. It can be a bargaining chip for other terms and conditions in the term sheet, for example, the amount of investment, the number of representative on the board of directors, or the VCs wish to change the management team. The interview data shows that the allocation of ownership usually reflects the size of investment. These two variables (investment vs. property rights) tend to change, maybe several times, during a negotiation process. For VCs, the allocation of property rights is a natural process during a negotiation of alliance, but for the entrepreneur it is a hard reality to face. Many entrepreneurs

are passionate and emotional about their idea and their company. In their minds and hearts, they believe that they still own the whole company even after agreeing to an alliance, and cannot sometimes grasp the reality that they no longer own the company as a whole unit. As most VCs understand the dilemma the entrepreneurs are going through, VCs will try to explain to the entrepreneurs that in a trade situation like this, both parties have to give something in return. According to the VCs, they want the entrepreneurs to hold stakes in the company and negotiate for it. For entrepreneurs, property rights are a motivational factor for building and creating value for the company. If an entrepreneur does not fight to keep his ownership, then he may not be that motivated or concerned about his own company. According to a couple of VCs, some entrepreneurs are only interested in obtaining the investment to establish offices and buy expensive equipment, but do not really care about the business. In this situation, when the entrepreneur is not interested in negotiating and agrees to everything that is proposed, the VCs will usually start questioning the potential of this entrepreneur and the VCs might eventually walk away from the deal. The interview data shows that if the VCs are content with the allocation of property rights and thinks it is fairly distributed, the higher the chance for a successful outcome. Therefore, it is argued that the likelihood of reaching an agreement to form an alliance is greater when the VCs have a high perception of distributive fairness with a high reliance on the property rights. Thereby, the following proposition is raised:

***Proposition 1:*** *The higher the VCs perceived distributive fairness with a reliance on the property rights, the higher is the possibility for a successful strategic alliance formation.*

The analysis is motivated by rationality in the case of analyzing negotiation process between VC firms and start-up companies. According to the venture capitalists' expressions, it is coded that rationality is the degree of:

- collecting relevant comprehensive information
- thinking consistently to forecast what might happen in the near future
- making the decision that maximizes both parties' interests
- acting decently to help understand both sides better

Therefore, the measurements of rationality with the following questions are adopted:

- To what degree did you collect relevant information?
- To what degree did you think potential possibilities of conflicts or disagreements?
- To what degree did you maximize both parties' interests?
- To what degree did you make the other side to understand?

These questions were not asked directly, for the reason that it is hard to get a 0-100 score answer to these questions. Therefore, these questions were kept in mind during open conversations and summarizing the VCs' opinions while talking about the negotiation process. Generally, rationality can only be determined either by an emphasized or an ordinary tone based on what the VCs have done related to the VCs' information collection, disaster forecast, mutual understand, decision making and actions.

According to our interview data, the VC in Case A improved the possibility of maximizing negotiators' interests and minimizing conflicts or disagreements by emphasizing rationality during the negotiation process with the entrepreneur. As more interviews took place, this viewpoint has been shown to be effective from the VCs' experiences. One of the venture capitalists commented:

*“You need to explain to them [entrepreneurs] what the product is, who your potential customers are, or other possibilities [...], and make them understand what we are going to do. We try to bring them [disagreements] down to something that can be manageable and discussed [...], that's the only way to solve problems”*

*Venture capitalist, Case A*

Considering our measurements of procedural fairness (see Appendix 3 Justice Measure Items), rationality may be thought of as one of the indicators to procedural fairness. For example, rationality can reflect procedural consistency, which partly belongs to procedural fairness in the negotiation process. It is believed that the VCs focus on rationality indicates they have a very

high perception of procedural fairness. Specifically, they emphasize rationality by both parties through the need to comprehensively collect all relevant information, maximize both parties' interests by eliminating biases, and effective communication. The above discussion leads us to the following proposition:

***Proposition 2a:*** *The greater the VCs' emphasis on rationality by both parties, the higher the VC may perceive procedural fairness during the negotiation process.*

Like property rights, the allocation of control rights is another major issue in the negotiation of the strategic company alliance formation. Control rights decide how much control power the VC firm will have and how much influence it can bring to the operations of the start-up company, which is of equal importance to both the venture capitalist and entrepreneur during negotiations. For VCs, investing in a start-up company does not only mean investing capital, but also investing other related resources such as their industrial abilities, network and business experience. In other words, the VC firm provides a solution to help the start-up company quickly develop. Thus, the VCs have to have a certain amount of control power to ensure solutions are implemented in the start-up company, thereby keeping the start-up company on the right development track. Some VCs thought the control right of the management team was important. The interviewee from Case C wanted to change the management team when investing the start-up companies. The interviewee in Case D also thought the VC firm should have the right to change the management team if the VCs thought the team was not capable. Generally, some VCs paid much attention on the allocation of the control rights.

According to Ariño and Ring's (2010) research, a fairness allocation of control rights is influenced by reciprocal perceptions of procedural fairness. If the negotiation process was highly influenced by the perception of procedural fairness, it might lead to a fair allocation of control rights. As mentioned earlier, the control rights are essential for both parties. Both sides will try their best to gain more control power for themselves because of self-interests. That is why numerous problems about control rights arise in negotiations. Because of the perception of procedural fairness, the problems may be solved in the negotiation process. During negotiations,



if both parties expressed their concerns of the control rights directly, the mutual understanding for both sides were generated and they could reconsider what was more important to the VC firm and the start-up company. Influenced by the perception of procedural fairness, the allocation of control rights would be fair for the VCs and the entrepreneurs. This solution may be agreeable to both parties and also create the possibility of increasing the common benefits. This kind of agreement can be called a 'win-win' agreement. Once the issue of how to allocate control rights has been resolved to a 'win-win' situation, it will increase the probability of making an investment agreement. Hence, the following proposition is raised:

***Proposition 2b:*** *The higher the VCs perceive procedural fairness through a reliance on control rights, the higher the possibility of a successful strategic alliance formation.*

According to our interview data, it is found that not all VCs think of the property rights and control rights as the most important issues in negotiations. In Case B, the venture capitalist mentioned he and his partners are not driven by the shares of ownership and believe that the trust and respect between venture capitalists and the entrepreneurs are the most important factors in negotiations. The interviewee in Case F also pointed out that sometimes negotiations are all about trust. According to the previous literature review on fairness, the degree of trust and respect can be used to measure the perception of the interpersonal fairness.

All the interviewees from the seven cases admitted that trust and respect influenced the negotiations, but only the interviewees in Case B and Case F paid more attention to trust and respect in their cases. After reviewing the data from the two cases, an interesting point was found: the VCs previously knew or worked with the entrepreneurs. Several VCs mentioned that VCs and entrepreneurs had the basic mutual trust and respect from the beginning and then built the trust in the following negotiation process. Compared with the other five cases, the degree of initial trust and respect in Case B and Case F was higher due to the longer relationship between the parties. The VCs were familiar with the behavioral styles of the entrepreneurs and understood their ways of thinking. The mutual understanding could help the VCs in Case B and Case F to build a higher degree of trust in the following negotiation and avoid personal conflicts. To

summarize, the VCs in Case B and Case F had a higher degree of trust and respect upfront and further built up the relationships in the following negotiations. In other words, the interpersonal fairness perceived by interviewees in Case B and Case F was more than the interpersonal fairness perceived by the rest interviewees.

The alliance formation might benefit from the more perception of interpersonal fairness. First, the personal conflicts might be avoided in the negotiation because of mutual respects, which built a good foundation for the negotiation process. Second, the mutual trust created the good atmosphere for the negotiations, which eased the negotiation. Third, the mutual trust might make them have better understanding of each other's teams, which was thought of as one of the most important factors by some VCs. At last, influenced by the perception of interpersonal fairness, VCs and entrepreneurs might consider each other as the suitable partners in the following works and would be willing to work together, which might have encouraged them to form the alliance. Therefore, leading to the following proposition:

***Proposition 3a:*** *The higher the VCs perceive interpersonal fairness, the higher the possibility of a successful strategic alliance formation.*

The interviews showed that reaching an agreement between the VCs and the entrepreneur is a very complex matter. There are many terms and conditions that need to be negotiated between the VCs and the entrepreneurs, and they do not always manage to reach a successful agreement due to differences of opinion. The interview data showed that the relationship between the venture capitalist and the entrepreneur *may* affect the outcome of the negotiation. Most important is how the VCs perceive the entrepreneurs with regard to trust and respect. All the VCs that were interviewed were clear that a framework to build trust and respect has to be in place from the beginning and that trust is earned. If disagreements arise when trust and respect is weak or do not exist between the venture capitalists and the entrepreneurs, then the VCs would back off the deal and avoid spending more time, money, and effort on the negotiation. If interpersonal fairness is obviously present between the venture capitalist and the entrepreneur, then a BATNA may be presented to solve the disagreements between the two parties.

The preformed relationship between the venture capitalist and entrepreneur in Case B suggests that this relationship creates a higher level of trust and respect between the two parties, where the venture capitalist have a positive perception of interpersonal fairness. It suggests that a high perception of interpersonal fairness between VCs and entrepreneurs may lead to greater efforts to solve conflicts and disagreements during a negotiation by presenting a BATNA to reach an agreement. A BATNA can help both parties understand their options and see the negotiation from a different perspective. Therefore, the venture capitalist is also more willing to spend additional time and effort on the negotiation. A BATNA can influence the negotiation power and make both parties aware of their alternatives and be more confident in negotiating a solution that serves both interests and loosen up the disagreements (Fisher & Ury, 1981). In light of these observations and arguments, the following proposition is raised:

***Proposition 3b: BATNA may have a positive moderating effect on negotiating a successful strategic alliance formation.***

According to the previous literature review, the informational fairness is perceived by the VCs and entrepreneurs when the information exchange is effective. In negotiations, the quick response and high quality communication can ensure the efficiency of the information exchange. In each interview, all the venture capitalists mentioned that the communication between themselves and the entrepreneurs was good. The venture capitalist in Case C thought the speed of information exchange was very quick. She commented that “*the quicker the company needs the money, the faster the communication is*”. As noted from the interviewee in Case D, the response time was very short for both sides. Differ from the previous two venture capitalists, the venture capitalist in Case B emphasized the quality of the communication. He thought the clear and rational exchange of information was very important in the negotiation. Generally, the quick response and clear communication could make venture capitalists perceive a basic degree of informational fairness.

In negotiations, dishonesty usually decreases the perception of fairness. For example, during the negotiation process between a VC firm and a start-up company, the entrepreneur may hide

unfavorable information in order to gain the investment. However, the VCs would eventually discover the truth during the due diligence process and treat this dishonest behavior as *cheating*. In most cases, the VCs decide not to invest in the end. “[To] *lie is the worst*” as the venture capitalist in Case B said. In his opinion, the VCs and entrepreneurs should be open to each other, which may increase the perception of information fairness.

As mentioned earlier, in Cases B and F the VCs knew the entrepreneurs prior to their negotiations. Because of their personal relationship, the communication between the two parties in both cases might be more intensive than that in the other five cases. Besides that, they were familiar with their style of talking and expressions, which might make them to understand each other easily and also avoid misunderstandings. In other words, the information exchange in the two cases was clearer. Thus, the efficiency of communication based on pre-personal connection might be higher than the first encounter. The venture capitalists in the two cases may perceive more informational fairness.

In Case B and Case F, the intensive and clear communications made the VCs and the entrepreneurs share more information and effectively increase the mutual understanding. According to Lamming and his colleagues’ (2006) research, wider information sharing can create transparency. Besides that, the possibility of sharing important information is also higher in the two cases because of the intensive communications and mutual understanding. In the coded concepts, effective communication and sensitive information sharing between participants in negotiations were thought of as transparency. Thus, transparency can be thought of as the result of the high perception of informational fairness.

Because of the high perception of informational fairness, the VCs and entrepreneurs in Case B and Case F understood each other’s core interests and important concerns in the negotiation process. On one hand, each party might give up some interests which were not so important for them to avoid conflicts. Fewer conflicts might result in the more smooth negotiation process and increase the possibility of alliance formation. On the other hand, they could propose a solution based on the concerns from both sides. The better solution might be accepted easier by both

parties, thereby increasing the chance of alliance formation. Therefore, the fourth proposition was:

***Proposition 4:** The higher the VCs perceive the entrepreneurs' understanding of informational fairness, the more likely are both parties to act transparent towards each other, which may increase the chance of a successful strategic alliance formation.*

According to the current interview data, it is difficult to conclude which type of fairness is the most significant in strategic alliance formation between venture capital firms and start-up companies. From this research, it can be only summarized that all these four types of fairness play an important role during the negotiation process from the venture capitalists' viewpoint.

## 6. Implications and conclusions

### 6.1 Conclusions

Strategic alliances between venture capital firms and start-up companies can enhance the competitive advantage by discovering new opportunities and exploit new skills and resources. Although strategic alliances have become a popular method for business development, the process of forming an alliance is a difficult barrier to cross. As one of the most critical issues in the alliance formation phase, the negotiation process has been an important research subject for numerous academics. During the last two decades, the practice of negotiation has been influenced by the perception of fairness. Regarding recent studies about implementation of fairness theory, researchers have recognized the tendency for negotiators to perceive fairness when they negotiate.

Our interview data have implied the fact that every venture capitalist has perceived the four types of fairness (distributive fairness, procedural fairness, interpersonal fairness and informational fairness) during the negotiation process with the entrepreneurs. Based on these finding, understanding of the research question is further developed: *How do perceptions of fairness affect negotiation outcomes during strategic alliance formation between VC firms and start-up companies?* In order to address this question, we suggested that even though each venture capitalist may have a perception of the four types of fairness, the significant difference of the four types to the VCs is the different levels of perceived fairness. For example, some VCs may emphasize distributive fairness, while others might pay attention to interpersonal fairness.

It is proposed in this thesis that the extent of fairness perception with the four types of fairness by the venture capitalist may affect the final outcome of the negotiation in the alliance formation. However, the interactions between the different types of fairness and negotiation outcome of a successful alliance formation are not only determined by the perception of fairness itself, but also involve other variables. Thus, it is suggested that property rights and control rights play a significant role of connecting fairness perception and successful negotiation. *BATNAs*, on the other hand, have a positive moderating effect on fairness perception and the final outcome.

Our interview data suggests that both problem-solving and compromising strategies may lead to successful strategic alliance formations. By examining previous articles about these theoretical negotiation strategies in a real-world context, the significant effect that a problem-solving strategy may lead both sides to make an agreement of investment in an alliance formation phase, has been successfully proven. Our finding also indicates that a compromising strategy based on mutual trust or transparent information sharing will also lead to a successful alliance in the formation phase, which has empirically complemented the dual concern model to some extent.

Current studies of empirical assessment on effects of different negotiation strategies in the phase of alliances formation remain sparse. Our new findings of how fairness perception influences alliance formation are contributed to the research field of alliance formation by implementing fairness theory with three variables (property rights, control rights, and BATNA). Meanwhile, our study has empirically examined negotiation strategies by consistently stressing the importance of negotiation theory. Based on our new findings, a framework of the interaction between fairness perception and negotiation outcome in alliance formation based on fairness theory has been developed. In terms of the business world, our research can benefit entrepreneurs through a deeper understanding of how the negotiation process is performed and how VCs think during the process.

## **6.2 Limitations of the study**

This research has empirically assessed negotiation strategies and their implementations in strategic alliance formation between the VC firms and start-up companies. This research has only found useful data on the problem-solving strategy and the compromising strategy, and lacks sufficient data on the contending strategy. No data has been retrieved on the yielding strategy. Therefore, their influence on alliance formation is unknown. While the fairness theory has been successfully applied to negotiations and their successful alliance formations, the time limitation did not allow an extensive research on which of the four fairness types are the most significant. Also, our research has only focused on the negotiation process from the VCs perspective. How the entrepreneurs perceive fairness has not been studied and are unknown in this research.

In addition, because of the short time span and tight budgets, the demographic for the interviews was narrowed down to Oslo only. As there are not many VC firms in Oslo and some VCs may not be willing to participate in our research, it was only possible to interview seven of the fifteen companies contacted. Furthermore, there were no access to important documents (term sheet and shareholder agreement) regarding the negotiations between VCs and entrepreneurs.

The cases studied in this thesis were not ongoing and some of them occurred several years ago. Thus, it is inevitable that some interviewees may have forgotten certain details about their negotiations. The interview data was mainly obtained through the interviews with the venture capitalists and follow-up questions sent by emails. These limitations may be threats to the reliability of our research.

While this thesis has its main focus on successful cases, minimal attention has been directed to the factors that may lead to unsuccessful outcomes.

### **6.3 Future research**

Although this thesis may provide some contributions to the research field of strategic alliance formation by illustrating the interaction between fairness perception and the negotiation outcomes of making an agreement, there are still some research vacancies that need to be discussed by other researchers. Given that the research is a cross-sectional design, it was only able to assess cases that were closed and retold by the VCs, which can give room for subjectivity. Therefore, for future research a better approach could be to conduct a longitudinal study, giving the researchers the ability to follow real-time negotiations between VCs and entrepreneurs. In this way, the entire process from the first meeting to deal closing can be followed and documented with minimal data loss. Considering that it is not known how the entrepreneurs perceive fairness in our current research, a longitudinal study provides the opportunity to observe how VCs and entrepreneurs engage in negotiations and examine how they perceive fairness towards each other.



Qualitative techniques are suitable for our subject in the field of strategic alliance formation because it is too complex to be simply answered by yes or no. However, the qualitative data collected cannot be mathematically analyzed in the same comprehensive way as quantitative results; they can only provide us a general guide to the trend of new aspects in our research. Therefore, the future research may focus on mathematical analysis by using quantitative methods.

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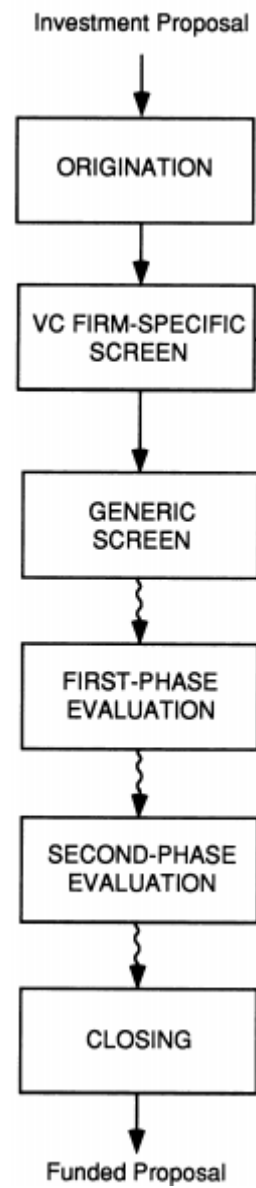
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Zartman, I. W. and C. o. F. Relations (1989). *Ripe for resolution: Conflict and intervention in Africa*, Oxford University Press New York.

# Appendix

## Appendix 1: Venture capital investment process<sup>11</sup>



<sup>11</sup> Fried & Hisrich, Toward a Model of Venture Capital Investment Decision Making, 1994

## Appendix 2: Alliance formation phases discovered by previous researcher<sup>12</sup>

	<i>1. Formation</i>	<i>2. Operation</i>	<i>3. Outcome</i>
Brouthers et al. (1997)	<ul style="list-style-type: none"> <li>• Selecting mode of operation</li> <li>• Locating partners</li> <li>• Negotiation</li> </ul>	<ul style="list-style-type: none"> <li>• Managing the alliance</li> </ul>	<ul style="list-style-type: none"> <li>• Evaluating performance</li> </ul>
Das and Teng (1997)	<ul style="list-style-type: none"> <li>• Choosing an alliance strategy</li> <li>• Selecting partners</li> <li>• Negotiation</li> <li>• Setting up the alliance</li> </ul>	<ul style="list-style-type: none"> <li>• Operation</li> </ul>	<ul style="list-style-type: none"> <li>• Evaluation</li> <li>• Modification</li> </ul>
D'Aunno and Zuckman (1987)	<ul style="list-style-type: none"> <li>• Emergence of a coalition</li> </ul>	<ul style="list-style-type: none"> <li>• Transition to a coalition</li> </ul>	<ul style="list-style-type: none"> <li>• Maturity</li> <li>• Crossroads</li> </ul>
Kanter (1994)	<ul style="list-style-type: none"> <li>• Selection and courtship</li> <li>• Getting engaged</li> <li>• Setting up housekeeping</li> </ul>	<ul style="list-style-type: none"> <li>• Learning to collaborate</li> </ul>	<ul style="list-style-type: none"> <li>• Changing within</li> </ul>
Ring and Van de Ven (1994)	<ul style="list-style-type: none"> <li>• Negotiation</li> <li>• Commitment</li> </ul>	<ul style="list-style-type: none"> <li>• Execution</li> </ul>	<ul style="list-style-type: none"> <li>• Assessment</li> </ul>
Spekman et al. (1996)	<ul style="list-style-type: none"> <li>• Anticipation</li> <li>• Engagement</li> <li>• Valuation</li> </ul>	<ul style="list-style-type: none"> <li>• Coordination</li> <li>• Investment</li> </ul>	<ul style="list-style-type: none"> <li>• Stabilization</li> <li>• Decision</li> </ul>

<sup>12</sup> Source: Das & Teng (2002). "The dynamics of alliance conditions in the alliance development process" Management Decision 49(8): 1235-1256.

### Appendix 3: Justice Measure Items<sup>13</sup>

Measure item	Source on which item is based
<b>Procedural justice</b>	
<b>The following items refer to the procedures used to arrive at your (outcome)</b>	
<b>1. Have you been able to express your views and feelings during those procedures?</b>	Thibaut & Walker (1975)
<b>2. Have you had influence over the (outcome) arrived at by those procedures?</b>	Thibaut & Walker (1975)
<b>3. Have those procedures been applied consistently?</b>	Leventhal (1980)
<b>4. Have those procedures been free of bias?</b>	Leventhal (1980)
<b>5. Have those procedures been based on accurate information?</b>	Leventhal (1980)
<b>6. Have you been able to appeal the (outcome) arrived at by those procedures?</b>	Leventhal (1980)
<b>7. Have those procedures upheld ethical and moral standards?</b>	Leventhal (1980)
<b>Distributive justice</b>	
<b>The following items refer to your (outcome).</b>	
<b>1. Does your (outcome) reflect the effort you have put into your work?</b>	Leventhal (1976)
<b>2. Is your (outcome) appropriate for the work you have completed?</b>	Leventhal (1976)
<b>3. Does your (outcome) reflect what you have contributed to the organization?</b>	Leventhal (1976)
<b>4. Is your (outcome) justified, given your performance</b>	Leventhal (1976)
<b>Interpersonal justice</b>	
<b>The following items refer to (the authority figure who enacted the procedure).</b>	
<b>1. Has (he/she) treated you in a polite manner?</b>	Bies & Moag (1986)
<b>2. Has (he/she) treated you with dignity?</b>	Bies & Moag (1986)
<b>3. Has (he/she) treated you with respect?</b>	Bies & Moag (1986)
<b>4. Has (he/she) refrained from improper remarks or comments?</b>	Bies & Moag (1986)
<b>Informational justice</b>	
<b>The following items refer to (the authority figure who enacted the procedure).</b>	
<b>1. Has (he/she) been candid in (his/her) communications with you?</b>	Bies & Moag (1986)
<b>2. Has (he/she) explained the procedures thoroughly?</b>	Bies & Moag (1986)
<b>3. Were (his/her) explanations regarding the procedures reasonable?</b>	Shapiro et al. (1994)
<b>4. Has (he/she) communicated details in a timely manner?</b>	Shapiro et al. (1994)
<b>5. Has (he/she) seemed to tailor (his/her) communications to individuals' specific needs?</b>	Shapiro et al. (1994)

<sup>13</sup> Source: Colquitt, J. A., D. E. Conlon, et al. (2001). "Justice at the millennium: a meta-analytic review of 25 years of organizational justice research." *Journal of applied psychology* 86(3): 425.



## Appendix 4: Question guide

### Question Guide

*(The following questions are related to one (specific) short term investment case)*

1. Brief introduction
  - a) *How did you find each other? Who was the representative in the process of negotiation?*
  - b) *How much time did you spend on the entire process (from the first contact to contract signing)?*
2. When negotiating with the entrepreneur, did you use any kind of negotiation strategy? Can you describe the characteristics of the negotiation strategies?
3. Have you ever experienced being dissatisfied with the entrepreneurial team? How did you solve this matter?
4. Can you think of a couple of specific factors that (firmly) determined the final outcome of the negotiation?
5. How much shares of ownership did you intend to get and what did you eventually agree on? Was there a big difference between the initial investment and the final agreement?
6. Have you been able to express your views and feelings during those procedures? Have you had influence over the (outcome) arrived at by those procedures? Have those procedures been applied consistently?
7. We think both trust and respect play critical roles when negotiating. What do you think of this opinion?
8. What do you think of the communication efficiency between you and the entrepreneur? What was the normal response time for feedbacks between you and the entrepreneur? If you find the outcome of decision was wrong, did you blame yourself or others?
9. Can you elaborate on an unsuccessful negotiation case and some key factors that affected the outcome?
10. Let's do a test to check what kinds of strategies you used (under academic definition).
  - A. A concern for your firm's own outcome and an equally salient concern for the other party's outcome
  - B. A high concern for your own outcome accompanied by a low concern for the other party's outcome
  - C. A concern for other's outcome is high and concern for your own outcome is low
  - D. A moderate amount of concern for your own outcome as well as for the other party's outcome

**Appendix 5: Overview of each case**

		<b>Firm 1</b>	<b>Firm 2</b>	<b>Firm 3</b>	<b>Firm 4</b>	<b>Firm 5</b>	<b>Firm 6</b>	<b>Firm 7</b>
<b>Background of VC firms</b>	<b>Year of establishment</b>	2001	2001	2006	1996	1886	1985	2006
	<b>Investment industry</b>	Energy IT Media Mobile Semi-conductor Hardware Software	Software ICT Electronics Semi-conductors Life-Science Energy Clean-tech Industrial	ICT Life-Science Clean-tech Industrial Oil-tech Marine-tech	Digital Infrastructure Media E-Commerce-Platforms Energy	IT Media Energy Life-Science oil/offshore	ICT Life-Science oil/offshore Industrial Marine-tech Media	ICT oil/offshore renewable-energy
	<b>No. funds</b>	2	2	2	1	1	1	3
		<b>Case A</b>	<b>Case B</b>	<b>Case C</b>	<b>Case D</b>	<b>Case E</b>	<b>Case F</b>	<b>Case G</b>
<b>One Specific Case</b>	<b>How they found each other</b>	Met at conference	The entrepreneur came to VC	The entrepreneur sent an email to VC	The VCs looked up the company	Met at Connect forum	The entrepreneur contacted VC	Network
	<b>Representative</b>	Partner	Partner	Partner	General Partner	Partner	Partner	Partner
	<b>Length of negotiation</b>	3-4 months	7 months	5 months	4-5 months	6 weeks	6 months	1 year
	<b>Investment time</b>	2 years	3 years	Unknown	3 years	Unknown	Unknown	Unknown