



Financing decisions as a source of conflict in venture boards[☆]

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ABSTRACT

Governance scholarship has suggested that venture boards should be structured so as to stimulate internal conflict. However, structure is a weak predictor of board effectiveness. Moreover, conflict can be dysfunctional, especially when it is focused on relationships rather than tasks. We show that venture boards experience more relationship conflict when they make financing decisions that involve devaluation of the venture and that this effect is moderated by whether the CEO is a founder. Our findings should prompt venture governance scholars to reconsider the importance of board structure, the value of board conflict and the behavior of founder- versus non-founder CEOs.

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1. Executive summary

The literature on boards of directors suggests that boards are well-served by the presence of conflict and that, therefore, they should be structured so as to stimulate internal conflict (Monks and Minow, 1995; Pearce and Zahra, 1991). This view is reflected in the conventional wisdom that the best boards have a high proportion of “outside” directors, a CEO who is not also the board chair, and board members holding significant ownership stakes (Finkelstein and Mooney, 2003). In the high-potential venture setting, where governance is critical, the boards of venture capital-backed firms (or, “venture boards”) are typically structured in a way that strongly aligns with these conventional prescriptions: such boards are dominated by outsiders who hold significant equity in the venture, and CEO duality is the exception (Gompers and Lerner, 2000; Rosenstein et al., 1993). However, the literature on conflict and its correlates is much more cautious regarding the efficacy of inducing conflict (DeDreu and Weingart, 2003; Jehn and Bendersky, 2003). Furthermore, empirical evidence has revealed a weak connection between board structure and organizational performance in firms large and small (Deutsch, 2005; Finkelstein and Mooney, 2003; Huse, 2000). These findings suggest that the structure-conflict-outcome model requires further theoretical development. Some scholars have suggested that insight is needed into the specific events that intervene between the structural “inputs” and decision “outputs” to clarify how and why the process unfolds as it does (Van de Ven and Engleman, 2004; Zahra, 2007).

In this study, we examine how venture board conflict is influenced by one class of events peculiar to venture capital: the staging of investments through multiple financing “rounds” (Sahlman, 1990). Venture capital-backed firms raise capital in exchange for equity in punctuated events called financing rounds. The venture board decides whether, when, and on what terms these financings occur. Although the economic significance of venture financing events is widely appreciated (e.g., Janney and Folta, 2003; Kaplan and Strömberg, 2003), less is known about how such events affect the way venture boards interact. A key premise of our study is that the valuation associated with this decision – specifically whether the firm is valued at a higher or lower price

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(Scannell, 2003) – is likely to affect conflict in the venture board, above and beyond the conflict that may be explained by board structure or composition. Another key premise of our study is that conflict is a multi-faceted phenomenon: although conflict over tasks (which is often called “task conflict”) may improve decision quality, task conflict is often accompanied by interpersonal antipathy or disaffection (i.e., “relationship conflict”), which generally has destructive effects on the quality of a group’s decisions and on a group’s long-term functioning (DeDreu, 2008).

We predicted that venture boards will experience more of both task conflict and relationship conflict when they decide to accept new financing at a reduced valuation, i.e., when a “down round” of financing occurs (Scannell, 2003). In addition, based on the possibility that the CEOs of new ventures may behave differently depending on whether they are also founders of the firms they manage (e.g., Rubenson and Gupta, 1997; Wasserman, 2006), we also predicted that the link between a reduced valuation and relationship conflict would be especially acute on boards with founder-CEOs. We tested these predictions on 161 venture boards that accepted financing in the year 2002. We found that down rounds are indeed associated with more relationship conflict as well as more task conflict. However, we were also surprised to find that boards with founder-CEOs experienced slightly more conflict in down rounds than did boards with non-founder CEOs, but substantially less conflict in ordinary financings.

2. Introduction

Researchers have studied boards of directors and their role in the governance of organizations for several decades (Johnson et al., 1996; Uhlaner et al., 2007). This stream of work has often argued that boards are well served by the presence of conflict and that, therefore, they should be structured so as to stimulate internal conflict (Monks and Minow, 1995; Pearce and Zahra, 1991). This view is reflected in the conventional wisdom that the best boards have a high proportion of “outside” directors, a CEO who is not also the chair, and board members holding significant ownership stakes (Finkelstein and Mooney, 2003). Two powerful and parallel logics undergird this wisdom. First, an agency-theoretic logic holds that mechanisms should be in place to ensure that the legitimate interests of non-management shareholders are vigorously represented and to curb the tendencies of internal managers to dominate board decision making (e.g., Sahlman, 1990). Second, a cognitive logic holds that the ambiguous and complex problems boards face require them to draw on multiple perspectives to reach superior decisions (e.g., Forbes and Milliken, 1999). In short, it has become an article of faith in the study of governance that firms with boards that are structured to represent and surface conflicting ideas will outperform those with inferior structures.

In the high-potential venture setting, understanding how and why governance structure relates to outcomes as it does is critical (Fried et al., 1998). Establishing the appropriate governance arrangements may make the difference between failure and survival, or between eking out an inadequate subsistence return versus realizing the kind of explosive growth sought by external equity investors. It is not surprising, therefore, that the governance arrangements typically utilized in the boards of venture capital-backed firms (henceforth referred to as “venture boards”) strongly align with the aforementioned prescriptions of how to curb agency risks: such boards are dominated by outsiders who hold significant equity in the venture, and CEO duality is the exception (Gompers and Lerner, 2000; Rosenstein et al., 1993).

However, empirical evidence has revealed a weak connection between board structure and the performance of firms large and small (Deutsch, 2005; Finkelstein and Mooney, 2003; Huse, 2000). These findings suggest that the structure–conflict–outcome model requires further theoretical development. Some scholars have suggested that insight is needed into the specific events that intervene between the structural “inputs” and decision “outputs” to clarify how and why the process unfolds as it does (Van de Ven and Engleman, 2004; Zahra, 2007). In this study, we examine how venture board conflict is influenced by one class of events peculiar to venture capital: the staging of investments through multiple financing “rounds” (Sahlman, 1990). Venture capital-backed firms raise additional capital in exchange for equity in punctuated events called financing rounds. The staging of financing rounds is a governance mechanism that allows investors to limit their risks to the previously committed funds, to periodically “re-value” both the company and the CEO, and to restructure the governance of the firm over time (Witt and Brachtendorf, 2006). The venture board decides whether, when, and on what terms these financings will occur. Although the economic significance of venture financing events is widely appreciated (e.g., Janney and Folta, 2003; Kaplan and Strömberg, 2003), less is known about how such events affect the way venture boards interact. The nature of financing events gives shape and meaning to the governance enacted by the venture board. A key premise of our study is that the valuation associated with this decision – specifically, whether the firm is valued at a higher or lower price (Scannell, 2003) – is likely to affect conflict in the board, above and beyond the conflict that may be explained by board structure or composition.

Conventional wisdom has advocated the purposeful “structuring in” of conflict among board members’ perspectives to reduce agency threats and increase productive task-centered conflict. However, this prescription overlooks some potentially dysfunctional consequences of inducing conflict. For example, evidence is building that task conflict may be accompanied by interpersonal antipathy or disaffection (i.e., relationship conflict) that may undermine both the quality of a group’s decisions as well as the group’s ability to function effectively over the long term (DeDreu, 2008; Higashide and Birley, 2002). An important aim of our study, therefore, is to see if we can differentiate between bases of conflict and explain how and why both task and relationship conflict develop.

An aspect of venture boards potentially relevant to variations in relationship conflict, in particular, concerns the “type” of venture CEO – i.e., founder or non-founder. The venture governance literature has called attention to the possibility that new venture CEOs may behave differently and require different treatments depending on whether or not they are also founders of the firms they manage (e.g., Rubenson and Gupta, 1997; Wasserman, 2006). For example, one “widely-held belief within the venture capital industry” is that founders are rarely capable of leading the venture all the way through its growth processes (Wasserman, 2003: 167); further, some have speculated that founders may be more resistant than non-founders to advice provided by outside

board members (Busenitz et al., 1998). Anecdotal evidence in the popular press also evokes an image of the founder-CEO who considers the venture his or her “baby” and is emotionally and unreasonably attached to his or her own visions of its future (Gossage, 2003). Collectively, these views suggest that founder-CEOs pose great governance challenges. Yet, recent evidence has challenged these views, suggesting that founder-CEOs act in a steward-like manner that actually reduces conflict-of-interest problems and enhances venture development (He, 2008; Wasserman, 2003). These issues are theoretically important to understanding the sources and outcomes of conflict in venture boards. Therefore, we examine in this study not only the effects of financing events on conflict but also the potential moderating effects of CEO type.

3. Financing valuations and board conflict

Governance scholars have advocated structuring boards so as to stimulate conflict through the vigorous representation of diverse interests and views, based on the belief that this in turn will yield higher-quality decisions (Monks and Minow, 1995; Pearce and Zahra, 1991). For example, it is commonly believed that boards should include a high proportion of outside directors and a non-CEO chair, and that outside directors should have “skin in the game” — i.e., a level of ownership that strengthens their interest in the firm's success as well as their power to influence its direction (Daily and Johnson, 1997). Although increased ownership on the part of outside directors may increase goal-alignment, it will not eliminate, and may even exacerbate, directors' inclination to have honest disagreements about *how* goals should be achieved (Sapienza and Gupta, 1994). Similarly, it has been argued that board size affects conflict, although there is disagreement about whether larger or smaller boards are better suited to this purpose (Dalton et al., 1999). All told, however, research has failed to establish that “properly-structured” boards are in fact more effective (Deutsch, 2005; Johnson et al., 1996; Huse, 2000). We posit that one reason for the disconnect between “ideal” conceptions of board structure and board effectiveness is the failure to distinguish between functional and dysfunctional forms of conflict among board members (Finkelstein and Mooney, 2003).

3.1. Forms of conflict in boards

Conflict has been defined as “a process in which one party sees its interests opposed or negatively affected by another party” (Wall and Callister, 1995: 517). Conflict is a multi-faceted phenomenon, with two facets being the focus of most current work on group conflict: *task conflict* and *relationship conflict* (Barki and Hartwick, 2004; Jehn, 1995). Task conflict may be described as disagreement among group members about what should be done and how it should be done. Relationship conflict refers to interpersonal disaffection or negative emotions experienced among decision makers.

Although task and relationship conflict are distinct (Pearson et al., 2002), they often co-occur (DeDreu and Weingart, 2003). To the extent that the expression of disagreement about how to carry out tasks is frustrating or anxiety-provoking (Wall and Callister, 1995), it can result in concomitant negative emotions that may be interpreted personally (Pondy, 1967). Indeed, some scholars have depicted task and relationship conflict in a sequence in which the experience of task conflict leads to emotional reactions that, if not properly resolved, escalate into relationship conflict (e.g., Pondy, 1967). Similarly, some argue that task and relationship conflict are causally related such that task conflict may simply degrade or “spill over” into relationship conflict (e.g., Simons and Peterson, 2000). Nevertheless, there is evidence that relationship conflict can exist independent of task conflict (Jehn and Bendersky, 2003).

Research has concluded that conflict has critical implications for group effectiveness (Jehn and Bendersky, 2003). In a recent meta-analysis, for example, DeDreu and Weingart (2003) concluded that task and relationship conflict are both negatively related to group performance. The effects of task conflict are somewhat complex, because avoiding or suppressing task conflict can be counterproductive (Schweiger et al., 1989), and some research has shown that task conflict can enhance group performance under certain conditions (Jehn and Bendersky, 2003). But relationship conflict has been found to have an overwhelmingly negative effect on performance, perhaps because people's personal and emotional reactions inhibit their cognitive functioning (DeDreu and Weingart, 2003; DeDreu, 2008). Accordingly, Finkelstein and Mooney (2003) warned that relationship conflict is highly disruptive to boards, undermining the quality of their decisions as well as board members' collective ability to continue functioning effectively. Wan and Ong (2005) have found evidence to support this contention.

In short, although it is often thought that boards should be structured so as to facilitate conflict, board structure has proven to be a weak predictor of board effectiveness. The equivocality of these results suggests that either other factors impinge on the degree of conflict that occurs and/or that board structure engenders a type or level of conflict that is not productive. We propose that the type and level of conflict venture boards experience depends on the nature of the events boards confront as they operate. To test this general proposition, we focus on one of the most important and repeated events venture boards experience: the financing decision.

3.2. Financing rounds and venture board processes

A venture board oversees the major decisions of the venture and ensures that the firm has the correct leadership in place to achieve goals in accordance with shareholders' objectives (Gompers and Lerner, 2000). One of the key tools venture boards have at their disposal is oversight of the exchange of venture equity for capital, i.e., the venture's financing ‘rounds.’ Raising money in rounds or stages is a key governance tool, because it regulates the pace of venture progress, decision authority, and the distribution of rights to the venture's earnings (Kaplan and Strömberg, 2003). Ordinarily, the valuation of the venture increases between these

rounds, because the venture progresses and risk decreases (Witt and Brachtendorf, 2006). However, when the board raises new funds at a value lower than prior valuations, the firm experiences what venture capitalists call a “down round” (Gossage, 2003; Scannell, 2003).

In a down round, the nature of the task and the tenor of discussions can alter dramatically. Down rounds defy the ordinary expectations of a venture's board. They pose decision challenges beyond those faced in ordinary rounds: e.g., whether and when to take the new money is more difficult to decide, and questions are raised regarding the causes of low valuations. This latter problem appears especially apt to invoke blaming and to be taken personally by the CEO. Furthermore, while CEOs' equity positions are typically protected in up rounds (i.e., their ownership share will be maintained without their buying new shares), the same is not necessarily true when the venture's value has gone down (Gompers and Lerner, 2000). In short, board processes are likely to be different in down rounds versus up rounds. (For simplicity, we refer to instances in which funding was accepted at an equal or higher valuation as “up rounds.”)

3.3. Effects of financing valuations on task conflict

We begin with the premise that financing valuation stimulates task conflict. The logic for this premise is derived from conflict theory (Deutsch, 1949; Emerson, 1962), which points to three critical conditions that lead to conflict. Specifically, conflict results when: (a) two or more parties are interdependent on one another to achieve their objectives, (b) the objectives are highly important to the parties, and (c) viable alternatives to mutual dependence exist. These factors are present in any financing decision, but the pressure attending these conditions is more pronounced in down rounds than in up rounds.

Down-round decisions are difficult to resolve in a mutually beneficial manner, because owners are faced with agreeing to recognize losses. Further, existing contracts provide for share re-distribution when valuations go below certain levels; these provisions protect some classes of shareholders at the expense of others (Wilmerding, 2003). This interdependence demands more coordination and makes it more difficult and painful for the board to achieve full cooperation among all parties. In addition, board members considering down rounds are likely to perceive few viable alternatives. If the venture is faring poorly, board members' other options may include liquidation or bankruptcy (Wilmerding, 2003). The process of choosing among such unattractive alternatives will likely lead group members to argue more intensely about what to do and how to do it. Finally, the potential consequences that board members personally face are more severe in a down round than in an up round in that board members face greater financial and professional risk. Thus, board members will be more motivated to fight for their own positions and preferences in down rounds.

In summary, given the complex interdependency, the lack of attractive alternatives and the severity of outcomes, venture boards accepting down-round financing will likely experience greater conflict over the decision itself. Thus, we offer our first hypothesis:

Hypothesis 1. Boards accepting a down round of financing experience more task conflict than those accepting an up round.

3.4. The effects of financing valuations on relationship conflict

As we noted above, task conflict and relationship conflict often co-occur. Thus, one might expect groups making down-round decisions to experience greater relationship conflict than those making up-round decisions. In fact, not all task conflicts escalate to the level of intensity typically associated with relationship conflict (Pondy, 1967). However, features of down-round decisions – namely their greater emotionality and personalization – increase the probability that relationship conflict will develop.

Because the problems under consideration in a down round are likely to generate strong negative emotions, down-round financing is likely to engender higher levels of relationship conflict than up-round decisions. Pondy (1967) argued that conflict manifests itself in an emotional manner to the extent that the parties involved are already experiencing anxiety over organizational demands. Whether driven by market forces or mismanagement, the circumstances leading boards to consider a down round of financing are more grave and urgent than those associated with up rounds. The demands of such circumstances create stress and anxiety for the venture's management team and board (Scannell, 2003). This heightened level of negative emotion, according to Pondy, predisposes board members to experience stronger emotion as conflicts arise. This argument is consistent both with Weick's (1979) thesis that negative emotions can interfere with information processing and with Shepherd's (2003) portrayal of entrepreneurs' reactions to business failure as a kind of “short-circuiting” of their cognitive responses to the problems at hand.

The personalization of disagreement that occurs in relationship conflict is more likely to occur in discussions concerning down-round financing. A down round is typically a sign of poor performance (Gladstone and Gladstone, 2001). During economic downturns, however, a down round can occur even if the venture is meeting expectations. Managers of ventures facing down rounds during such unfavorable times may justifiably feel that “blame” pointed in their direction is unwarranted and unfair. Conversely, outside investors, losing money on multiple fronts, may be frustrated by what they perceive to be venture managers' excuse-making and denial of culpability. To the extent that the board's efforts to make sense of the firm's predicament involves calling into question the character or competence of one or more board members, the experience of conflict among board members will be more pronounced and more personalized than in boards accepting an up round. Therefore, we hypothesize:

Hypothesis 2. Boards accepting a down round of financing experience more relationship conflict than those accepting an up round.

3.5. The moderating effect of founder-CEOs

Down rounds bring conflicts of interest into focus and prompt task-based disagreements about the merits and terms of such financing agreements. Also, down rounds heighten the emotionality of the decision situation and personalize boards' sense-making processes. We propose that the presence of a CEO who is also a founder of the firm escalates the personalization of conflict, compounding the emotionality that occurs in deliberations of down-round financing decisions, thereby exacerbating the impact of such events on relationship conflict.

Pondy (1967) held that conflict manifests itself in an emotional manner when the parties involved have a strong psychological investment in the activity. Such a strong investment is to be expected of founder-CEOs, who often have objectives associated with the venture that extend beyond wealth creation and may include considerations such as esteem and autonomy (e.g., Sarasvathy et al., 1998). Moreover, founder-CEOs are likely to feel a greater sense of psychological ownership over the firm than are non-founder CEOs (Wasserman, 2006). Psychological ownership refers to individuals' feelings of personal responsibility and emotional attachment to the venture (Van Dyne and Pierce, 2004). Founder-CEOs have invested more "sweat equity" in the firm and have been responsible for nurturing and shaping the systems and culture of the venture from the beginning. Relative to non-founder CEOs, founder-CEOs likely experience stronger bonds to the venture, resulting in greater relationship conflict among board members of a founder-led board when the board faces a down-round financing decision.

Further, in cases where the board attributes a down round primarily to the firm's own performance shortfalls, board members are more likely to pin responsibility for those shortfalls on founders than on non-founders. This is because founders have been responsible for the shaping and direction of the venture from its inception; thus, board members are likely to infer that a founder's influence on the firm's condition is more direct, sustained and unambiguous than is the influence of a professional CEO. In addition, professional CEOs are likely to have been selected based on the input of some or perhaps even all of the same board members engaged in the focal financing decision. Indeed, Wasserman (2006) showed that non-founder CEOs are more likely to have been selected for that position by the firm's equity holders than are founder CEOs. Board members may be reluctant to find significant fault with a professional CEO under such circumstances out of a concern – whether conscious or unconscious – that doing so would raise questions about the quality of their own judgment at an earlier point.

Even when the board attributes the down round to market conditions rather than firm-specific causes, board members may still be prompted to critically evaluate a founder's continued role in the venture based on the belief that the firm's challenges have begun to outstrip the founder's own knowledge and skills and that a professional manager may be better able to navigate through difficult times (Christopher, 2001). Meanwhile, founders themselves, being more psychologically and emotionally invested in the firm than professional managers (Wasserman, 2006), are likely to be highly sensitive about such matters and, accordingly, are likely to interpret discussions of devaluation, bankruptcy, CEO-replacement or other negative alternatives associated with down rounds as though they reflect personal indictments of their own values or competence. Whether such perceptions are real or imagined, this state of affairs is likely to cause the debate to become more personalized and thereby provoke more relationship conflict:

Hypothesis 3. The positive relationship between down-round financing and relationship conflict is moderated by CEO founder status such that the relationship is stronger when the CEO is a founder.

We do not posit a moderating effect of founder status on task conflict. Our arguments for the role of founder status are based largely on the notion that the presence of a founder CEO enhances or exacerbates levels of negative emotion and personalization that are associated specifically with the development of relationship conflict. Accordingly, we do not expect founder status to affect the level of task conflict, which in itself does not require conditions of emotionality and personalization.

4. Method

We tested our hypotheses using archival and survey data for a sample of firms that received venture capital financing in 2002. Archival data were used to measure various objective characteristics of the sample firms and their boards. Survey data were used primarily to measure the boards' interaction processes and several CEO background characteristics.

4.1. Sample

The sample was drawn from the population of U.S.-based firms that received a round of venture capital financing in 2002. This population was identified using VentureXpert, a commercially-available database that tracks venture capital activity. We focused on a single country because the nature of venture capital and the norms and institutions of corporate governance differ significantly across countries (e.g., Sapienza et al., 1996). The population was further restricted to firms for which the database provided a complete mailing address and identified the CEO by name. The database included 2124 firms that met these criteria. To accommodate our own resource constraints, we randomly selected 1250 of these firms and addressed the initial mailing of our survey to the CEOs of these firms *via* surface mail. Valid addresses were not available for 321 ventures, rendering a potential sample of 929 firms.

In total, 161 CEOs provided data on the key variables (i.e., financing valuation and conflict). Accounting for firms that could not be contacted, this gave us an effective response rate of 17%. CEOs were the key informant for the survey data. On average, the CEOs

were 49 years old, had 16 years of industry experience, and had been CEO for the last 3 years. The boards averaged 5 members, 70% of whom were “outside” board members. On average, the ventures were 8 years old, had 65 employees, had 93% of assets located in the U.S. and generated 90.5% of sales domestically. The firms represented a range of industries, and 23% of the firms were Internet-related. On average, the firms had received 3 rounds of financing totaling \$26 million in venture capital financing, including \$8 million in the most recent round.

We explored the potential for nonresponse bias in two ways. First, we compared early respondents to late respondents (Armstrong and Overton, 1977). Analyses of variance conducted using these two groups revealed no significant differences on any of the predictor or criterion variables. We also compared a randomly-selected subset (20%) of non-respondent firms to the respondent firms with respect to their age, size and geographic location using data from VentureXpert. Again, there were no significant differences between respondents and non-respondents with respect to these variables.

4.2. Survey procedure

We sent a survey packet containing a cover letter, a questionnaire and a reply envelope to each of the CEOs via surface mail. We also allowed respondents to reply online if they preferred. Reminders were mailed to non-respondents, and we sent email reminders in cases where VentureXpert provided email addresses. Survey data were linked with archival data from the VentureXpert database using a unique identification code. The survey asked respondents to characterize the board's decision process in connection with a single, actual decision that was similar across the sample firms in its content and timing. Because all the firms had received financing in 2002, the calendar year immediately prior to our data collection, we used that financing decision as the focal decision for the survey. If they had more than one financing in 2002, we asked them to respond regarding the last financing round. We asked about the 2002 financing decision for three reasons. First, focusing on the same type of decision during the same time frame enabled us to hold constant the characteristics and timing of the decision, which might otherwise have introduced random error or bias into our findings. Second, by focusing on a specific recent decision, we sought to minimize the potential distortion that can occur when respondents are asked to recall a generalized impression representing multiple events over time as opposed to concrete events from the recent past (Miller et al., 1997). Finally, by focusing on 2002, an economically challenging year for venture capital (Grimes, 2002), we enhanced the likelihood that our sample would include a significant number of up and down-round financings, thereby allowing statistical comparisons on our key question.

Our study focused on board processes at the group level. Because we used CEOs as key informants, we faced the risk that their view of board processes differed systematically from those of other board members. However, the risks of this error vary depending on the circumstances. For example, the risk is heightened when respondents lack intimate knowledge of phenomena, when they are asked about large-scale organizational or multi-organizational phenomena, when they are asked to report on events from the distant past, or when they are asked to report on people's beliefs or intentions as opposed to relatively concrete events or behaviors (Chen et al., 1993; Glick et al., 1990). In our study, CEOs answered specific questions pertaining to the recent behaviors of a small group of people about which they had extensive, first-hand knowledge. Recent studies provide empirical support for the view that individual respondents do provide reliable and valid responses regarding such group phenomena (e.g., Atuahene-Gima and Murray, 2004; Westphal, 1999).

Nevertheless, following the example of several recent studies of group-level phenomena (e.g., Blum et al., 1994; Simsek et al., 2005), we also gathered data from the fellow board members of a subset of ventures to assess the reliability and validity of CEOs' assessments. We solicited responses from identifiable board members at every venture for which we had already received a CEO response. Twenty-seven board members responded, providing a set of secondary respondents for 17% of the firms in the final sample. On average, these additional board members were 47 years old, had 22 years of industry experience, and had previously been involved with 9 new ventures. Consistent with the fact that venture boards are generally “outsider-dominated,” 22 of our 27 secondary respondents (81%) were outside board members, such as venture capitalists or other investors. There were no significant differences between the 27 firms for which we had a second informant and the remainder of the sample on firm characteristics, CEO characteristics, or any of the main and control variables.

To assess the reliability of our key informants, we calculated intra-class correlation coefficients (ICCs) of their responses with those of the secondary respondents. ICC examines the extent to which one rater is as reliable as any other from the same set. An ICC (1,1) greater than .12 indicates acceptable reliability (Bliese, 2000). ICCs for our perceptual measures all exceeded this criterion (task conflict = .14; relationship conflict = .63; performance = .46 and distributive nature of the decision = .60), suggesting that the CEO was a reliable informant for perceptions of board processes and outcomes. The fact that the ICC was larger for relationship conflict than for task conflict suggests board members show more consensus over the degree of relationship conflict, perhaps because this form of conflict is more readily observable than conflict of ideas. As an additional check on reliability, we re-ran these reliability analyses using only the 22 secondary respondents who were also outside board members, and the results were not materially different.

4.3. Measures

Where possible, we adapted existing and validated survey measures. To further assure the construct validity of the measures, we first administered a pilot test of survey items to 10 top managers and board members. We drew on input from interviews with these respondents to improve the interpretability of the items and minimize social desirability bias. The items are listed in Appendix A.

4.3.1. Task and relationship conflict

We adapted Jehn's (1995) scales to assess perceived levels of task and relationship conflict among board members in connection with the focal decision. The *task conflict* measure consisted of four items assessing disagreements over task-related issues. The *relationship conflict* measure consisted of four items measuring the degree of emotional and personalized conflict. Given our focus on the board's collective processes, the referent for all items was the board – as opposed to the individual's – experience. Each item was rated on a five-point Likert-type scale (1 = *Not at all* to 5 = *Very much*). We averaged the items for each scale to form an overall index. Both scales had acceptable reliability, as indicated by the coefficient alpha (α) estimates of .92 and .96 for task and relationship conflict, respectively. Finally, although prior research indicates that the two scales represent distinct dimensions of conflict (e.g., Pearson et al., 2002), we performed a confirmatory factor analysis comparing a single-factor structure to a two-factor structure. The results further supported the dimensionality of these scales, indicating that a two-factor structure provided a significantly better fit (two factor: $RMR = .03$; $NFI = .98$, $\chi^2_{13} = 22.27$; one factor: $RMR = .09$; $NFI = .85$, $\chi^2_{14} = 162.30$; $\chi^2_{diff} = 140.03$, $df_{diff} = 1$, $p < .01$).

4.3.2. Antecedents of conflict

Data on valuation and founder status were measured in the survey. *Financing valuation* was measured by asking respondents whether the last financing round was at a lower valuation than in the prior investment round (no = 1, an “up round,” and yes = 0, a “down round;” this coding allowed us to indicate higher valuations as positive numbers in our tables and tests). *CEO founder status* was measured by asking the CEO whether he or she was a founder of the firm (1 = yes, 0 = no).

4.3.3. Control variables

Our choice of control variables was guided by what prior literature has suggested would shape conflict in groups and by our own logic about what might influence conflict in venture boards. We obtained some of these variables from VentureXpert (venture age, board size, industry affiliation, financing round, and the percentage of new investors) and the rest from the survey.

To examine whether financing events and CEO status exert influence on conflict beyond the effects of board structure and the distribution of power within the board, we controlled for *board size*, *CEO-chairman duality* (i.e., whether the CEO was also the chair of the board), *percentage of CEO ownership*, and the *percentage of new investors*. We controlled for board size because it can impact conflict (Dalton et al., 1999). We controlled for whether the CEO was also the chair (1 = yes, 0 = no), because boards may exhibit less conflict when the CEO holds both positions and wields greater power. We controlled for the percentage of the firm's equity held by the CEO, because it may relate to influence in decision making. This control is also especially important in order to separate out financial stake from emotional response in founder- versus non-founder CEOs. To address potential effects of the financing round on the composition of ownership in the venture, we controlled for the *percentage of new investors* in this focal investment round, i.e., the percent of investors in the focal round who were investing for the first time.

Because CEOs who are less replaceable may have more power and control over decision making, we accounted for the substitutability of CEOs' human capital using three indicators: *CEO tenure* to account for their firm-specific human capital as well as *CEO industry experience* (in years) and *prior CEO startup experience* (i.e., the number of times they had previously served as CEO of a new venture) to account for their industry- and startup-specific human capital (Khurana, 2001).

As boards gain experience making similar kinds of decisions, they may develop routines or habits that render their decision processes more or less prone to conflict. We therefore controlled for *firm age* (in years) and the total *number of financing rounds* they had experienced, including the focal round, as proxies for the extent to which the board had experience in similar decisions.

We also controlled for industry and performance variations. First, reasoning that Internet-related firms might experience an especially high rate of devaluation during the time frame of our study, we controlled for whether or not the firm was in an *Internet-related industry* (1 = yes, 0 = no). Analyses conducted using alternative base cases of industry affiliation did not yield materially

Table 1
Means, standard deviations and correlations for study variables^a.

Variable	Mean	S.D.	1	2	3	4	5	6	7	8	9	10	11	12	13	14
1. Board size	4.86	2.12														
2. CEO-chairman duality ^b	0.09	0.28	.04													
3. Percent of CEO ownership	13.34	17.05	-.18	.00												
4. Percentage of new investors	0.54	0.40	-.32	-.12	.29											
5. CEO tenure	3.35	3.68	-.06	-.02	.23	.13										
6. CEO industry experience	16.25	9.06	.08	-.16	.06	-.14	.18									
7. Prior CEO startup experience	1.01	1.30	.15	.07	.00	-.11	-.11	.07								
8. Firm age	7.64	11.37	-.10	-.03	.27	.19	.38	.00	.01							
9. Number of financing rounds	3.18	2.24	.27	.01	-.32	-.55	.04	.08	.06	-.10						
10. Internet-related industry ^b	0.23	0.42	.18	-.06	.02	-.20	.09	.06	.03	-.13	.11					
11. Firm performance	2.83	1.11	.07	.09	.09	.11	.22	.11	-.01	.01	-.11	-.08				
12. CEO founder status ^b	0.46	0.50	-.09	.07	.29	.07	.25	-.03	-.08	-.03	-.01	.03	.25			
13. Financing valuation ^b	0.54	0.50	-.34	-.03	.20	.19	-.08	-.11	-.14	.05	-.28	-.24	.23	.10		
14. Task conflict	2.49	1.06	.28	.02	-.20	-.17	.03	-.06	-.02	-.09	.24	.06	-.13	-.12	-.34	
15. Relationship conflict	2.21	1.21	.20	.04	-.15	-.12	.01	-.08	.01	-.11	.17	.01	-.10	-.12	-.31	.73

^a Correlations greater than .15 are significant at $p < .05$.

^b CEO-chairman duality is coded 1 = yes, 0 = no; Internet Industry is coded 1 = yes, 0 = no; Financing valuation is coded 0 = down round, 1 = up round or neutral round; CEO Founder Status is coded 1 = yes, 0 = CEO no.

Table 2
Subgroup means and differences.

Variable	Down round		Up round		t
	Mean	S.D.	Mean	S.D.	
Board size	5.65	2.15	4.20	1.86	4.59*
CEO-chairman duality ^a	0.09	0.29	0.08	0.27	0.10
Percent of CEO ownership	9.58	13.44	16.53	19.10	-2.63*
Percentage of new investors	0.46	0.38	0.60	0.40	-2.40*
CEO tenure	3.66	3.95	3.09	3.44	0.98
CEO industry experience	17.31	9.36	15.34	8.74	1.38
Prior CEO startup experience	1.20	1.50	0.84	1.09	1.78
Firm age	7.00	11.16	8.19	11.58	-0.66
Number of financing rounds	3.85	2.23	2.61	2.10	3.62*
Internet-related industry ^a	0.34	0.48	0.14	0.35	9.03*
Firm performance	2.55	1.06	3.06	1.10	-2.94*
CEO founder status ^a	0.41	0.49	0.51	0.50	-1.62
Task conflict	2.87	1.04	2.16	0.97	4.49*
Relationship conflict	2.61	1.24	1.87	1.07	4.04*

* $p < .05$.

^a This variable is dichotomous. Means correspond to proportions, and differences between proportions are tested using chi-squared tests.

different results. Second, we controlled for perceptions of *firm performance*, to separate venture performance effects from valuation effects; we used perceived performance, because it is the board's perception of performance that is most salient to its decisions (DeClercq and Sapienza, 2006). We measured subjective assessments of performance with a two-item scale ($\alpha = .90$). The means, standard deviations, and correlations for all variables in the study are listed in Table 1. Subgroup means and differences are shown in Table 2.

4.3.4. Checks on financing type

Forty-six percent of our sample firms experienced lower valuations, and 54% equal or higher ones. The arguments for our hypotheses contend that, consistent with past theory on the contextual determinants of conflict, down-round decisions are associated with more negative outcome interdependence, less favorable alternatives, and greater importance induced by strained or weak performance. To check these assumptions, we examined the relationship between indicators of such factors and venture valuation. First, to proxy for *outcome interdependence*, we created a three item scale ($\alpha = .70$) measuring the perceived distributive nature of the decision, or the extent to which the decision was likely to be unequally beneficial or harmful to the members of the board. Second, we measured the *number of unfavorable alternatives* by asking whether each of the following was considered as an alternative to equity financing (1 = yes, 0 = no): merger/sale, bankruptcy, or debt financing. Finally, based on the reasoning that decisions involving poorly-performing firms posed a greater threat to board members' personal and professional stakes, we used our perceived *performance* measure as a proxy for the inverse of threat or strain. To conserve space, we do not report the full results here, but they support our assumptions: in down rounds, perceptions of unequal benefits/harm were significantly higher,

Table 3
Hierarchical regression analysis of the antecedents of task conflict.

Variable	Step 1		Step 2		Step 3	
	B	t	B	t	B	t
Board size	0.27	3.05**	0.20	2.21*	0.20	2.19*
CEO-chairman duality	0.02	0.21	0.00	0.02	-0.01	-0.08
Percent of CEO ownership	-0.08	-0.86	-0.04	-0.48	-0.02	-0.25
Percentage of new investors	0.00	-0.02	-0.03	-0.26	-0.03	-0.33
CEO tenure	0.16	1.68	0.12	1.28	0.12	1.25
CEO industry experience	-0.10	-1.17	-0.12	-1.45	-0.13	-1.58
Prior CEO startup experience	-0.05	-0.57	-0.07	-0.88	-0.09	-1.12
Firm age	-0.10	-1.08	-0.09	-1.02	-0.12	-1.33
Number of financing rounds	0.14	1.40	0.11	1.07	0.10	1.05
Internet-related industry	-0.02	-0.25	-0.06	-0.68	-0.05	-0.63
Firm performance	-0.13	-1.51	-0.07	-0.76	-0.06	-0.68
CEO founder status	-0.10	-1.07	-0.09	-1.06	-0.10	-1.14
(H1) Financing valuation			-0.24	-2.62**	-0.25	-2.75**
Financing \times CEO status					-0.16	-1.94
R ² (adjusted R ²)	.16	(.10)	.20	(.13)	.22	(.15)
F (df)	2.41*	(12,148)	2.84*	(13,147)	2.96*	(14,146)
ΔR^2			0.04		0.02	
F for ΔR^2			8.03*		3.77	

* $p < .05$, ** $p < .01$.

Table 4
Hierarchical regression analysis of the antecedents of relationship conflict.

Variable	Step 1		Step 2		Step 3	
	B	t	B	t	B	t
Board size	0.22	2.18	0.13	1.20	0.12	1.17
CEO-chairman duality	0.03	0.26	0.01	0.12	0.00	0.01
Percent of CEO ownership	−0.09	−0.86	0.00	−0.03	0.02	0.21
Percentage of new investors	0.00	0.04	−0.03	−0.22	−0.03	−0.29
CEO tenure	0.16	1.43	0.14	1.25	0.14	1.22
CEO industry experience	−0.12	−1.16	−0.16	−1.61	−0.17	−1.75
Prior CEO startup experience	0.00	−0.02	−0.04	−0.42	−0.06	−0.66
Firm age	−0.15	−1.38	−0.17	−1.57	−0.20	−1.89
Number of financing rounds	0.10	0.85	0.07	0.63	0.07	0.60
Internet-related industry	−0.07	−0.70	−0.11	−1.16	−0.11	−1.12
Firm performance	−0.15	−1.46	−0.04	−0.35	−0.03	−0.25
CEO founder status			−0.14	−1.35	−0.15	−1.43
(H2) Financing valuation			−0.31	−2.85**	−0.32	−2.99**
(H3) Financing × CEO status					−0.19	−2.02*
R ² (adjusted R ²)	.10	(.03)	.15	(.08)	.18	(.10)
F (df)	1.46	(11,149)	2.07*	(13,147)	2.26*	(14,146)
ΔR ²			.06		.02	
F for ΔR ²			5.01**		4.07*	

* $p < .05$, ** $p < .01$.

consideration of unfavorable alternatives was significantly higher, and perceived performance was significantly lower. Table 2 displays other differences in means across variables in down rounds versus up rounds.

5. Results

The hypotheses were tested using hierarchical regression analyses in which the control variables were entered in the first step, the predictors were entered in a second step, and the interaction of financing valuation and CEO founder status was entered at a third step. We used mean substitution to account for missing data on the control variables. Hypothesis 1 stated that boards would experience more task conflict when they accepted down rounds. These results appear in Step 2 of Table 3. Note that we used CEO founder status as a control variable in the regression predicting task conflict (Table 3); we entered this variable as a control in order to test a model that is parallel to the model tested on relationship conflict presented in Table 4, wherein CEO founder status is

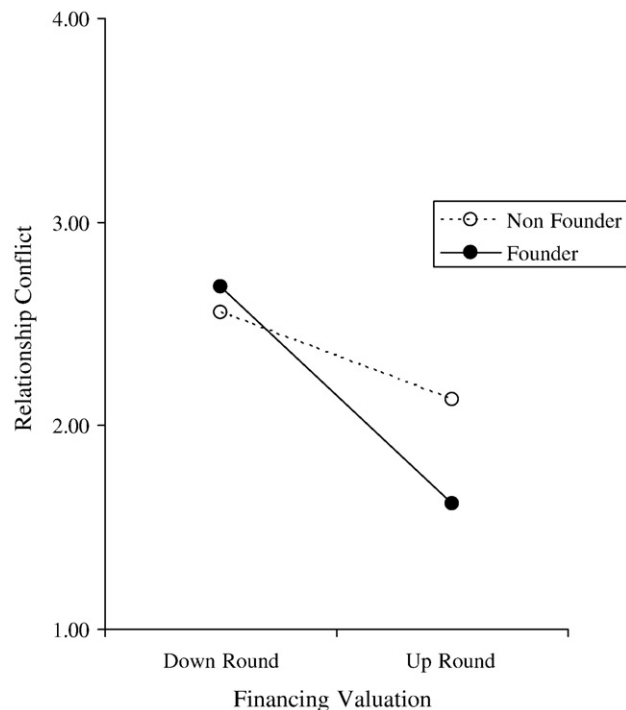


Fig. 1. The interaction of financing valuation and CEO founder status on relationship conflict.

predicted to have a moderating effect. The results supported **Hypothesis 1**, indicating that task conflict was greater when the board made a down-round decision ($B = -0.24$, $t_{147} = -2.62$, $p < .01$; $m_{\text{down round}} = 2.87$, S.D. = 1.04; $m_{\text{up round}} = 2.16$, S.D. = 0.97). **Hypothesis 2** stated that boards would experience more relationship conflict when they accepted down rounds. As indicated in **Table 4, Step 2**, this hypothesis was supported in that there was significantly more relationship conflict in down rounds than in up rounds ($B = -0.31$, $t_{147} = -2.85$, $p < .01$; $m_{\text{down round}} = 2.61$, S.D. = 1.24; $m_{\text{up round}} = 1.87$, S.D. = 1.07).

Hypothesis 3 predicted that the relationship between financing valuation and relationship conflict would be stronger when the CEO was also the founder. The results of this hypothesis test were not exactly as we anticipated. **Step 3 of Table 4** reveals that the coefficient representing the interaction of financing valuation and founder status was significant and negative ($B = -0.19$, $t_{146} = -2.02$, $p < .05$) when regressed on relationship conflict. Given that both of the variables included in the interaction term were dichotomous, we interpreted this interaction by plotting the mean levels of relationship conflict for each of the four subgroups. The plot is illustrated in **Fig. 1**. The plot reveals that there was negligibly higher relationship conflict during down rounds in boards with a founder-CEO, but substantially lower relationship conflict during ordinary financings in boards with a founder-CEO. Thus, although the change in slope was as we predicted, what was not anticipated was that relationship conflict would be so low in ordinary rounds for founder-led ventures.

6. Discussion

We examined how the nature of staged financing affects conflict in venture boards. We also examined how these effects are moderated by whether or not the CEO is a founder of the venture. Our focus on conflict was motivated by theory and research on upper echelon groups suggesting that the effects of conflict on decision making and performance may vary depending on the type of conflict a board experiences (e.g., Higashide and Birley, 2002; Wan and Ong, 2005). We developed and tested hypotheses on two critical types of conflict: task and relationship conflict. We predicted that venture boards would experience more of both types of conflict when the venture accepts a round of financing at a lower value than previously achieved (i.e., a “down round”). These predictions were supported. We also predicted that relationship conflict in founder-led boards would be more sensitive to down rounds than would be the case in non-founder-led-boards. We did observe an interaction of founder status and financing valuation, but the pattern was somewhat contrary to what we expected.

The average levels of task and relationship conflict observed in this study suggest a low level of conflict within boards, which may seem surprising given the potentially contentious nature of financing decisions. However, research has recognized that groups generally do not like to engage in conflict and tend to avoid it when possible (Schweiger et al., 1989). Further, the board's power structure and norms may inhibit members from expressing dissent. Thus, conflict may be unexpressed during the group process and under-reported in surveys; decision makers may be especially reluctant to admit to interpersonal friction. Suppression of conflict is seldom productive, however, because it does not allow for the resolution of underlying differences among board members and can promote deep-seated resentments, which are likely to prove counterproductive over the long run (Schweiger et al., 1989). Thus, reports of relatively moderate levels of conflict may still reflect relatively counterproductive states.

Moreover, even when the overall means are low, slight increases in conflict may result in serious negative consequences. Studies of upper echelon teams typically report mean conflict levels below the midpoint, with ranges and variances similar to what we observed (e.g., Li and Hambrick, 2005; Olson et al., 2007; Parayitam and Dooley, 2007; Simons and Peterson, 2000; Wan and Ong, 2005). Despite the overall low levels of conflict in these studies, the observed differences in conflict were significantly related to board performance (Wan and Ong, 2005), decision quality (Olson et al., 2007; Parayitam and Dooley, 2007), and venture performance (Li and Hambrick, 2005). In short, for intact functioning teams, the mean levels of conflict we observed are not unusual. Yet, the differences in conflict levels observed in down versus up rounds (see **Table 2**) are of a magnitude that may eventually affect how well these boards function.

6.1. On the effects of financing decisions on conflict

Our results regarding the differences in conflict during down rounds versus up rounds are revealing and important. Given that groups are generally driven to suppress conflict, why is it that we observe significantly higher levels of both task and relationship conflict merely because a venture accepts a new round of financing at a lower valuation than in the prior financing event? We suspect that, in the first place, boards of ventures accepting a down round will want to make sense of the failure to achieve the expected progress. Although one might well observe that receiving any financing under the dire circumstances of the venture market in 2002 may be seen as an achievement, for many firms this event may have been their first instance of an apparent step backward. Furthermore, in comparison to those receiving up rounds, the boards of firms receiving down rounds were likely more motivated to exchange ideas about what led to this troubled situation (i.e., to what extent did it reflect the firm's performance or market events) and how this situation could be avoided in the future. To the extent that the consideration of such questions led some to speculate that things could have been done differently, either by the board itself or by venture management, charges and counter-charges may have ensued. When blame is added to loss, emotions can run high and conflict that is ordinarily repressed may be given expression and personalized.

Our results show that the nature of intertemporal events can significantly affect the way board governance is executed (Wasserman, 2003). Task conflict is relatively low during up rounds, which in ordinary times are more common. It may well be that accepting a financing round that realizes the desired increase in venture value is neither difficult nor controversial. The higher level of task conflict in down rounds, on the other hand, may reflect activity and alertness on the part of the board in facing a significant

challenge. On the other hand, our results show that, in contrast to the lower levels of relationship conflict associated with up rounds, significantly higher levels of relationship conflict are expressed during the more difficult and less pleasant situation of accepting money in down rounds. Thus, relationship conflict appears to be heightened amid circumstances where we might expect that it would be especially important for board members to be able to cooperate effectively in the future. These observations reveal that personal identification and emotion may play a larger role in the execution of governance than is generally assumed. In theory, the men and women chosen for venture boards have clear fiduciary responsibility for the venture and, in the case of venture capitalists, for the limited partners who provide funds. They are expected to enact these responsibilities dispassionately, impersonally and objectively. Our results suggest that hard times short-circuit some of these principles and may threaten both the decision at hand and boards' ability to function well as a decision-making group in the future (Shepherd, 2003). After all, as Finkelstein and Mooney (2003) observed, "despite their lofty positions, board members are people, and they are subject to the same biases and behaviors that all of us are" (p. 104). Given the volatile circumstances and events encountered by high-potential new ventures, scholars should strive to understand more fully how and why such events may influence venture boards' behaviors.

6.2. On the moderating effect of founder- versus non-founder CEOs

We were surprised to observe the differences in relative relationship conflict between founder-led and non-founder-led boards in up rounds. As Fig. 1 and Table 2 show, the levels of relationship conflict were about the same in founder-led and non-founder-led boards during a down round of financing, but the lowest level of relationship conflict occurred for firms that experienced an up round and had a founder-CEO. We had anticipated that relationship conflict might generally be higher in founder-led firms because of founders' greater personal attachment to the venture (Wasserman, 2006). The empirical observation in our study that founder-led boards have less relationship conflict in ordinary up-round financings may be explained by interpreting anew their attachment to the venture. The pattern we observed fits with Wasserman's (2006) depiction of founders as being less demanding than "professional" CEOs. Wasserman argued that, because of their greater attachment, founders are apt to behave more like "stewards" of their firms than are non-founders, whom he depicts as psychologically detached and economically motivated "agents." It may be that in prosperous times – i.e., when faced with prospects of additional funding without devaluation – founder-CEOs are willing to suspend their parochial or personal interests in deference to the common good of the firm and refrain from stirring personal debate among board members. The view that their strong attachment to the firm makes them vulnerable to receiving less compensation fits this interpretation.

One might interpret the higher level of relationship conflict experienced by founder-led firms during down rounds as an emotional response to the venture itself being threatened. An alternative explanation would be that fear of equity loss, not *psychological* ownership, causes this more emotional response in founders. Our data, however, do not support this interpretation. We controlled for CEO ownership so that our results revealed that founder status had effects beyond any ownership effects. Indeed, CEO ownership was unrelated to conflict of either type in our study.

6.3. Limitations

Limitations of our study should be kept in mind in interpreting the results. First, as we mentioned earlier, our reliance on CEOs' reports for the process variables represents an important limitation in that CEOs' characterizations of board decision processes may differ systematically from those of other board members. Measures of board process based on input from multiple board members at each of the sample firms would have helped us address this possibility more fully, but we were unable to obtain enough responses from other board members to make this feasible. Second, the generalizability of this study may be limited to closely-held ventures where the board is highly involved in financing decisions; our conclusions may not apply to other types of decisions or firms. An additional consideration is that the time frame of data collection may have affected the interpretation of the financing valuation. We have argued that the negative circumstances associated with down rounds would result in conflict. However, given that financing was generally scarce in 2002, getting financing at all may have been seen as a relatively positive event at that time. Thus, down rounds may have even stronger effects during ordinary times. Further, because our focus was on comparing down rounds to the rest of the financings, we did not distinguish between up rounds and neutral rounds. It is possible, however, that neutral and up rounds might exert different effects on conflict, so our inability to detect such effects represents an additional limitation.

Finally, our sample does not include firms that *considered* accepting a round of financing but ultimately chose not to. The experiences of such firms would have been helpful as a means of understanding the more general phenomenon of decisions in which a round of financing was considered and could have helped us to more fully understand the dynamics and effects of board power. The correlation between financing valuation and CEO ownership ($r = .20$) raises the possibility that power distribution among board members exerted some impact on ventures' decisions to accept particular financing types. It is noteworthy, however, that our results hold in the face of controlling for elements of power, such as ownership, board size and CEO duality. This limitation results from our use of an archival database of completed financings as a means of identifying firms that had recently experienced the same type of decision. The limitation might be overcome by using a survey approach to identify a wider sample of firms.

6.4. Contributions and implications

Our study contributes to the understanding of how various factors influence venture governance. As in other studies (e.g., Wan and Ong, 2005), we observed in our sample rather little association between structural or compositional factors and the intervening processes. Only board size was significantly related to task conflict; none of our control variables was significantly

related to relationship conflict. We do not doubt that structural mechanisms impact aspects of governance, for example by protecting competing interests, providing adequate feedback, and monitoring for malfeasance and competence. However, what our results suggest is that to the extent that such structural mechanisms do work, they do not work through inducing task or relationship conflict. We found no evidence that board structure or composition significantly shape conflict. We must observe, however, that venture boards tend to be similarly composed, following an industry recipe as to how they are structured (Sahlman, 1990). Thus, our sample may not reflect the level of variation in board structure that exists in other environments and that might influence variations in conflict in those settings.

Few academic studies have explored the use and meaning of financing round as a substantive variable. However, Witt and Brachtendorf (2006) examined the use of staged financing as a governance device addressing issues of business risk, agency risks, and transaction costs. They found that staging increased when business risks were high and decreased as transaction costs rose; they found no effect of agency risks (either adverse selection or opportunism) on the propensity to use staging as a governance option. Their work revealed the significance of financing rounds themselves as events in the lives of venture capital-backed businesses. They estimated that a single round consumed venture resources at a rate of about 68 manager-days each and about \$50,000 in cash expenses, including legal fees, document preparation, copying and the like. In addition, Wasserman (2003) examined financing rounds as one of several predictors of the replacement of founder-CEOs. Wasserman (2003) found that reaching a new product development milestone or achieving a new round of financing would increase the susceptibility of the founder to replacement; he labeled this the “paradox of entrepreneurial success.”

We found that not only is the *occurrence* of a funding round important, but also too is the *nature* of the financing round. An empirical observation regarding financing rounds worth mentioning from our study is that the number of prior rounds of financing in the venture has no relationship with the amount of conflict experienced. One may have expected conflict to decrease with experience, as venture boards learn how to deal with the stresses of financing rounds. Alternatively, one might expect that many disagreements are ironed out immediately preceding initial investment so that conflict would be substantially lower early on than it will become later as conditions change. However, Tables 3 and 4 indicate that in our study conflict was not significantly related to variables that reflect the length of time since initial investment (e.g., number of financing rounds and firm age). Consequently, venture boards appear to be equally susceptible to task conflict and relationship conflict even if they have been through similar experiences before; however, since we do not have longitudinal data on conflict, such a conclusion is speculative. Collectively, these three studies suggest that financing rounds are important events in the development of ventures and that they merit further research attention. For example, scholars could explore how the nature and occurrence of financing events affect interaction processes among managers and employees within a venture, not only among board members. Scholars could also study more directly whether the *functionality* of conflict varies with the stage in the process in which it occurs.

One of the most fascinating but under-studied issues in new venture governance is the assumption that founders are rarely capable of bringing firms all the way from inception to initial public offering [IPO] (Rubenson and Gupta, 1997). Wasserman (2003: 166) quotes one of the founders of a venture capital-backed firm as saying that the only reason s/he remained as the CEO to that point in time was because the venture itself was not at either end of the performance spectrum. The implication is that venture capitalists routinely remove founders as CEO when they are either doing very poorly or very well. Such an implication fits Sapienza's (1992) finding that venture capitalists tend to be most involved with their investments either when they are doing extremely poorly or when they are doing extremely well. Wasserman (2003) speculated that the reason behind the paradoxical removal of founders when ventures have successfully achieved positive milestones is because of the belief in the venture capital community that founders' skills are limited and less useful beyond a certain stage of development.

The wisdom of this recipe has not been systematically examined, however. In one of the few studies to take up this question directly, He (2008) examined the post-IPO performance of newly public firms in the 1998 to 2002 time period. He (2008) found that founder-led firms outperformed those with professional CEOs, both in terms of the magnitude of financial returns and in terms of survival rates. Proponents of the “stewardship” view of founder-CEO leadership may argue that these founders' care and attachment to their ventures reduces agency costs and results in better performance and more tenacious oversight for survival than those led by professional CEOs. Our study might explain why this care and attachment may be related to longer-term success. Our finding that venture boards with founder-CEOs experience less relationship conflict in ordinary financing rounds may mean that such boards are likely to be stable and remain intact over time. In short, perhaps the value of administrative skill in managing larger organizations that professional CEOs bring to the table is outweighed by the cohesiveness and mutuality induced by a leader whose interests are less self-centered and more venture-focused. Regardless of the causes, however, our own study and those of He (2008) and Wasserman (2003, 2006) suggest that the value and limitations of founder-CEOs should be more deeply investigated.

More generally, whereas past work on venture governance has often focused on the structural elements that allow investors to monitor and control entrepreneurs, our findings here help to advance an alternative, complementary view of venture governance as a process by which heterogeneous and interdependent groups of people work together over time to solve common problems (e.g., Huse, 2007; Graebner and Eisenhardt, 2004). Combining the latter, process-oriented view with the more traditional, structural approach yields a perspective that challenges firms to adopt governance structures *and practices* that are conducive to effective monitoring and control and yet simultaneously conducive to strong, respectful and cooperative working relationships (Arthurs and Busenitz, 2003; Uhlaner et al., 2007). In future work, therefore, scholars should strive to clarify more precisely how venture boards can combine effective monitoring with strong personal relationships that enable their members to pool and recombine knowledge, leverage each others' connections and realize other advantages of effective, well-integrated groups.

We indicated earlier that financing rounds themselves are important events and should be investigated further. Scholars wishing to develop a more complete explanation of their emergence and use should keep in mind that such a theory should also be

able to explain why they do not emerge even when the conditions for their appearance are present (Phan, 2004: 617). Our study suggests that such considerations should go beyond environmental elements and concrete structural elements of the governance system and consider the nature of the processes that evolve as governance mechanisms are enacted.

7. Conclusion

We set out to explore whether venture boards making financing decisions would be more or less prone to conflict under different financing conditions. Specifically, we predicted that venture boards would experience more of both task and relationship conflict when the venture received a down round of financing, and we found support for these predictions. We also predicted that the impact of down rounds would be stronger when the CEO was a founder. Although the results revealed the expected interaction, they also revealed a pattern of relationship conflict that contained an important surprise: founder-led boards actually experience less of the destructive relationship conflict in ordinary up-round financings. Taken together, our findings enhance the venture governance literature by illustrating some underappreciated implications of financing events, by underscoring the critical distinction between task and relationship conflict on venture boards, and by highlighting some complex ways in which the presence of founder-CEOs can influence venture governance.

Appendix A. Scales used in the questionnaire

Task conflict

To what extent did members of the board have conflicting opinions regarding this financing decision?
 To what extent were there conflicts about ideas among board members?
 How much conflict about the financing decision was there among board members?
 To what extent were there differences of opinion among board members?

Relationship conflict

How much interpersonal friction was there among board members when this decision was discussed?
 How much tension was there among board members?
 How much were personality conflicts evident among board members?
 How much emotional conflict was there among board members?

Firm performance

How satisfied were you with the operating performance of the firm prior to 2002?
 How satisfied were you with the firm's ability to meet benchmarks prior to 2002?

Perceived distributive nature of the decision

To what extent did board members stand to realize different outcomes from this financing decision?
 To what extent did all parties figure to gain or lose equally in this financing decision? [*reverse coded*]
 To what extent was it true that at least one party was disadvantaged in this decision?

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