THE PLACEMENT OF NOMINEE DIRECTOR AS A CONTROLLING MECHANISM IN VENTURE CAPITAL INVESTMENT

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Thesis Submitted to
Othman Yeop Abdullah Graduate School of Business,
Universiti Utara Malaysia,
in Fulfillment of the Requirement for the Degree of Doctor of Philosophy

Kolej Perniagaan
(College of Business)
Universiti Utara Malaysia

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(Title of the Thesis / Dissertation)

Program Pengajian : **Doctor of Philosophy**
(Programme of Study)

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ABSTRACT

Within the context of venture capital financing, the high level of investment risk combined with the absence of collateral have forced many venture capitalists to perform a strict evaluation process in establishing the requirement for full information disclosure and implementing continuous monitoring on their investee firms. However, the absence of representatives from the venture capital company on the investee firm's board of directors has been cited to significantly impact venture capitalist endeavors to protect their investment interests. Venture capitalists have claimed that this absence has exposed their business to the possibility of having agency problem and triggered management conflicts with their investee firms. Hypothesizing that a nominee director may affect the venture relationship between venture capitalists and their investee firms, this study utilizes a cross-sectional survey research design. The questionnaires were distributed to all identified Malaysian venture capital companies through the mailing procedure. Of the 44 surveys distributed, a total of 35 sets was returned, generating a response rate of 79.55%. The main test results revealed an unexpected finding because the presence of a nominee director insignificantly influenced the venture relationship between the venture capitalists and their investees. Further results showed that the controlling mechanism through the placement of a nominee director failed to moderate the influence of managerial factors, namely Deal Origination and Screening, Evaluating Venture Proposal, Contracting and Deal Structuring, Monitoring and Post Investment Activities and Risk Management with respect to management conflicts. The results prove that the placement of nominee director in Malaysia did not serve as a moderating factor between venture capitalists and their investee firms. Further study should concentrate on other controlling factors and examine whether they could reduce the possibility of conflict occurrence in venture cooperation.

Keywords: Venture capital, venture capitalists, conflict, nominee director, entrepreneurs

ABSTRAK

Dalam konteks pembiayaan modal teroka, gabungan tahap risiko pelaburan yang tinggi dan ketiadaan cagaran menyebabkan ramai pemodal teroka melaksanakan proses penilaian yang ketat bagi memperoleh maklumat yang lengkap dan menjalankan pemantauan secara berterusan ke atas firma yang mereka biaya. Namun demikian, ketiadaan wakil daripada syarikat modal teroka dalam ahli lembaga pengarah syarikat yang dibiaya dikatakan telah memberikan impak yang signifikan terhadap usaha pemodal teroka untuk melindungi kepentingan pelaburan mereka. Pemodal teroka mendakwa keadaan ini akan mendedahkan perniagaan mereka kepada masalah agensi yang boleh mencetuskan konflik pengurusan dengan firma yang mereka biaya. Kajian ini mengupayakan kaedah kajian rentas yang berteraskan tinjauan soal selidik dengan berlandaskan hipotesis bahawa penempatan pengarah penama mempengaruhi hubungan usaha niaga di antara pemodal teroka dengan firma yang dibiaya. Borang soal selidik telah diagihkan melalui prosedur mel kepada semua syarikat modal teroka Malaysia yang telah dikenalpasti. Sejumlah 35 borang soal selidik dikembalikan daripada 44 borang yang diedarkan, dan ini menjana kadar maklum balas sebanyak 79.55%. Hasil dapatan utama memperlihatkan dapatan di luar jangka, iaitu kehadiran pengarah penama didapati tidak memberikan pengaruh yang signifikan ke atas hubungan usaha niaga di antara pemodal teroka dan firma yang mereka biaya. Dapatan seterusnya menunjukkan bahawa mekanisma kawalan melalui penempatan pengarah penama gagal untuk menyederhanakan pengaruh faktor pengurusan, iaitu penilaian awal dan penjanaan urusniaga, penilaian cadangan usaha niaga, perjanjian usaha niaga dan penstrukturan urusniaga, aktiviti pemantauan dan aktiviti pasca pelaburan dan pengurusan risiko terhadap konflik pengurusan. Hasil kajian membuktikan bahawa penempatan pengarah penama di Malaysia tidak memberi apa-apa kesan penyederhana ke atas hubungan usaha niaga di antara pemodal teroka dengan firma yang dibiaya. Kajian lanjut perlu menumpukan kepada faktor kawalan yang lain serta meneliti sama ada faktor-faktor ini boleh mengurangkan kemungkinan berlakunya konflik dalam kerjasama usaha niaga.

Kata kunci: Modal teroka, pemodal teroka, konflik pengurusan, pengarah penama, usaha niaga

ACKNOWLEDGEMENT

First and foremost, I would like to express my humble gratitude to Allah the Almighty for bestowing upon me the courage, strength and good health to undergo this learning process. Without His blessings, this study may never have been undertaken.

I am deeply appreciative of the direction and support that my supervisors, Assoc. Prof. Dr. Mohd Sobri Minai and Dr. Esuh Ossai-Igwe Lucky extended throughout the completion of this study. Their scholarly advice and optimistic perspective throughout the development and completion of this study were extremely reassuring and character building. Their sacrifices, helps and patience were vital in helping me to complete this study.

To my mother, Hajjah Zainah bt. Ya'acob, thank you for your prayers and endless support. You have been a steady source of love and inspiration to me.

Finally, my family deserves more love and gratitude than I could possibly give and convey. My very special thanks and deepest appreciation are extended to my beloved wife, Dr. Firdaus bt. Romli, for her sacrifice, patience and constant encouragement. To my dearest children, Afiq, Nur Khadijah and Nur Hajar, who have innocently sacrificed many of the childhood joys because of this undertaking, I am very grateful for their understanding. Although they had to go through the trauma of being neglected and took on additional responsibilities, they always have applied love and motivation as needed. Words cannot express my love and appreciation for each one of them.

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LIST OF ABBREVIATIONS

EVCA	European Venture Capital Association
ICT	Information Communication Technology
MAVCAP	Malaysia Venture Capital Management Berhad
MTDC	Malaysia Technological Development Corporation
MVCA	Malaysia Venture Capital and Private Equity Association
MVCDC	Malaysia Venture Capital Development Council
NEAC	National Economic Action Council
NPV	Net Present Value
NVCA	National Venture Capital Association
PUNB	Perbadanan Usahawan Nasional Berhad
R&D	Research and Development
SC	Security Commission
VCCC	Venture Capital Consultative Council

CHAPTER ONE

INTRODUCTION

1.1 INTRODUCTION

According to Posthuma (2012), Croucher, Holody, Hicks, Oommen, and DeMaris (2011) and Daly, Lee, Soutar, and Rasmi (2010), it is vital for managers to comprehend the reasons, impacts and processes of conflict arise in the daily business activities. It is because conflict has impacted on people and organization as a whole. Therefore, it is not surprising when conflict, its determinants and the way people perceive, handle and manage it have become a major area of study in organizational research (Cerni, Curtis & Colmar, 2012; Thomas, Thomas & Schaubhut, 2008). One of the major streams within this research is regarding the investigation of the determinants and the consequences of the conflict, resulting in a large body of research into conflict's management that is mainly searched for the best conflict handling techniques and resolutions for the parties involved (Cerni *et al.*, 2012; Giacomantonio, Pierro & Kruglanski, 2011; Huang, 2010; Liu, Fu & Liu, 2009; Ozkalp, Sungur & Ozdemir, 2009; Fu, Yan, Li, Wang & Peng, 2008; Green, 2008; Boonsathorn, 2007; Wang, Jing & Klossek, 2007; White III, Joplin & Salama, 2007; Darling & Walker, 2001).

While research on conflict has been popular in a wide range of fields and contexts, including management (Montes, Rodrı´guez & Serrano, 2012; Reuver & Woerkom, 2010), small business management (Frank, Kessler, Nose´ & Suchy, 2011), teaching and education (Ommering, 2011; Rutaisire & Gahima, 2009; Canen & Canen, 2008;

Tatum & Eberlin, 2006; Heaney, 2001; Henkin, Cistone & Dee, 2000), healthcare (Bergin & Savage, 2011; Skjorshammer, 2001), marketing (Atorough & Martin, 2012; Darling & Heller, 2011; Dawes & Massey, 2005, 2007; Bennet & Savani, 2004), personal relationship (Yolles, Fink & Frieden, 2012; Kim, Wang, Kondo & Kim, 2007) and accounting (Nasution & Ostermark, 2012; Ahadiat & Ehrenreich, 1996), the research on conflict in the finance and investment context seems to get less attention especially in the venture capital investment area. This is obvious when direct studies attempted in this area are categorized as exploratory (Yitshaki, 2008; Sohaimi, 2004) and have been considered to offer a limited explanation of the conflict itself and on its determinants especially between venture capitalists and entrepreneurs within the venture capital investment context (Yitshaki, 2008).

Venture capital investments can be seen as an instance of interorganizational collaboration in which the venture capitalists connect with entrepreneurs to begin a new business venture (Gimmon, Yitshaki, Benjamin & Khavul, 2011; Gupta & Sapienza, 1992). Yitshaki (2008) and Ring and Van de Ven (1994) said this unique interorganizational cooperation begins with the negotiations, commitment and assessment before it can be officially contracted which involves equity exchanges. In this view, the relationship exists when the venture capitalists provide among others fund and network accessibility while the entrepreneurs provide the business ideas and technology abilities as a return with the main goal to create a successful business venture (Andrieu, 2013; Jääskeläinen, 2012; Sohaimi, 2004; Gomez-Mejia, Balkin & Welbourne, 1990). Thus, if both venture capitalists and entrepreneurs can unconditionally cooperate or combine their skills together, their venture business would have a better prospect for a better performance and more successful results. However, these must be achieved with minimum conflicts between them.

The continuing difficulties of overseeing venture business make it very essential for venture financiers to build a cordial friendship with the entrepreneurs in order to achieve mutual goals (Andrieu, 2013; Park & Steensma, 2012). However, the warm venture cooperation built between venture capitalists and entrepreneurs may still be interrupted by management conflict as highlighted by Yitshaki (2008) and Sohaimi (2004). For instance, the differences in management stance and variation in both parties' nature and characteristics have unfortunately contributed to the existence of management conflict between venture capitalists and entrepreneurs. As management conflict would influence the business outcome of the venture, it may also become one of the major barriers that prevent both venture capitalists and entrepreneurs from creating successful venture business.

Acknowledging this issue, this study attempts to examine the management conflict in venture capital investment scenario. It attempts to reveal the managerial factors contributing to the formation of management conflict in venture cooperation and how the controlling mechanism through the placement of a nominee director acts as a moderator in handling or addressing the conflict between venture capitalists and their investees in venture cooperation. It is concurred here that a closer look at this issue is essential in understanding the management conflict that occurred among the venture capitalists and entrepreneurs including the conflict resolutions.

1.2 RESEARCH BACKGROUND

Venture capitalists are recognized as one of the high risk capital providers which offer funding to any potential firms that have sound business ideas but lack of capital to materialize them. Venture capitalists do play middleman role between the fund providers that seek high investment profit and the entrepreneurs who are currently looking for funding. Therefore, the core business profit for the venture capitalists is the gain from the capital they have invested in venture businesses. The venture capital unique feature includes the involvement of venture capitalists in their venture business management and administration processes. Hence, it can be concluded that the venture capitalists receive money from the fund providers which usually comprise of institutional investors and then invest them in the venture businesses viewed as high potential (return on investment), which usually seen with high growth potential but associated with high risk (Cumming & Johan, 2010; Wright & Robbie, 1996).

Currently, the importance of small and medium firms in the employment creation, entrepreneurship and innovation is getting greater attention by policy makers and academicians (Lucky & Minai, 2011; Minai, Lucky & Olusegun, 2011). However, the small and medium firms' limited finance still the major headache that required solution and given proper attention by most economies (Nofsinger & Wang, 2011). Moreover, for these small and medium firms, their main assets are intangible assets, which are seldom to be accepted as collateral for financing purposes. All these make most authority pay serious attention to the agenda of the small and medium firms' development.

From the perspective of the venture capitalists, they do not come easily to these small and medium firms. This is due to the fact that it required thorough, calculated and administrative factors during and later part of the venture capitalists' choice of whether to take a risk in these firms is being decided. It is very crucial for the venture capitalists and those potential firms to carefully consider these managerial factors for deal origination and screening, evaluating venture proposal, deal structuring, monitoring and post investment activities, acquiring liquidity and risk management (Sohaimi, 2004).

This suggests that due to the riskiness of venture businesses, a strategic approach is usually used by the venture capitalists and potential firms in managing the enterprise ventures throughout the complete funding stage. That is, the recognition of many managerial factors by the venture capitalists and the firms are believed to be strategic and at the same time influence the enterprise performance. For instance, supposing the venture capitalists recognize an approach, which is different than the one recognized by the funded firms for overseeing, then, these dissimilarities to certain degree would influence other managerial concerns and finally their venture business performance.

1.3 PROBLEM STATEMENT

Venture capital investment will place both venture capitalists and the entrepreneurs in a unique relationship known as venture cooperation. This venture cooperation is administered by financial contracts and it must be signed by both venture capitalists and entrepreneurs before any capital commitments can be made by venture capitalists. Principally, this financial contract highlights both parties' responsibilities, obligations and disclosure rules that should be fulfilled throughout the venture cooperation life. In general, for the venture capitalists, they are playing their role as an agent to their principals, that comprise of the funds provider. The ability of their investments in providing good and profitable returns will definitely improve their reputation. Hence, this will also improve their opportunity to obtain more funds for future businesses. For the small and medium firms, as the borrower, they are performing their role as the agent to their venture capitalists principal, who need sound and profitable return for investing their money in the firms. This classification is crucial in highlighting the situation in venture capital investment where the venture capitalists, as the financiers, have the advantages when compared to the investee firms, as the borrower, in their venture financial agreement.

In developing the research framework, the use of principal-agent analysis for this study is crucial to provide a framework for the analysis regarding the connection between the venture capitalists and investee firms. Early clarification on this matter is necessary in this section to kick-start the discussion on this subject. Further explanation is provided later. Here, the venture capitalists are regarded as the principal while the enterprises owners (investee firms) is regarded as the agent in their association. It is argued here that the relationship will normally extend more than the simple capital provision. The association may also be complicated due to the small and medium firms' owner-manager who is seeking for venture capital, is the venture business majority shareholder, and thus has the objective of maintaining himself or herself as the principal legally in the context of the business. Nevertheless, this position change in the financial agreement among them. This is due to common element guiding the form in which the venture capitalists propose the firms with the chances to obtain additional required funds now and assumptions are used to classify venture capitalists as principal and investee firms as agent in their business association. The followings are the possible scenario when the new financial contract takes place:

(a) The venture capitalists have a tendency to have below 50% equity shareholding in the enterprises as a result of in the Malaysia's corporate culture, holding the majority share becomes an important issue due to the need to control the firm. The small and medium firms commonly are the majority shareholders of the venture businesses. In such extreme cases, one golden share is also claimed to be retained by them. In other words, they are reluctant to give control to others who have injected capital to the firms.

(b) Both venture capitalists and small and medium firms conclude on the financial agreement that guide their potential association in running the enterprises they have entered into the contract. Although the venture capitalists may not really want to get involved in the management, they actually emphasize on the important to ensure the capital injected being used on the agreed purposes. Usually, the venture capitalists involvement is limited to certain time limit, with finite life period, for example a few years. Once the agents manage to pay back, such contract matures.

Thus, based on the identified possible scenario, this research intends and emphasizes on the subscribing of the financial contract that is between venture capitalists and investee firms. The venture capitalists are to be identified as the principal. This principal controls the contractual details and assigns tasks. The investee firms perceived as the agent who accepts the power and they undertake some jobs as required by the venture capitalists. This view is in line with the works of (Gimmon *et al.*, 2011; Yitshaki, 2008; Sohaimi, 2004). The dominant motives for examining association are for the venture capitalists to gain profit from their investment. It is also for the investee firms to spread out the negative aspect of the risk the enterprise face, based on the contract they have signed. Within the context of this study, the venture capitalists is assumed, credibly and having neutral investment risk due to their large and diversified portfolios which comprise of their investment in many venture businesses. On the other hand, the investee firms are presumed, credibly and to be risk indisposed since the owner-managers fund, which is also including their goodwill, is already committed in the venture businesses.

However, the lack of perfect foresight may result in the venture capitalists as principal to confront the potential of partial agreement by the investee firms as agent in their venture cooperation. In other words, the effectiveness of the investee firms to complete their assigned tasks can only be judged by the venture capitalists in an indirect way. Normally, the agent is incompletely controlled and the agent has certain liberty that could tempt him or her to exploit the trust, i.e. by avoiding the risk and putting less effort in managing the venture business. In this view, the venture capitalists may be worried on the possible action of the investee firms, and thus may work toward precaution strategy and direct management involvement. Moreover, this may lead toward positive instead of non-natural business scenario which looks artificial. In addition, where asymmetries of information are significant between them, the investee firms may have strong tendency to defect from the venture financial contracts. This is because it is not difficult for the investee firms (the agent) to manipulate any strategic information to the venture capitalists regarding their enterprises to their short-term ends.

Thus, during the pre-investment stage, the relationship between the venture capitalists and the investee firms places the venture capitalists in a place where the adverse selection problem has to be addressed. For instance, granting financial assistance on the right firms is extremely important for any venture capitalists because the investee firms' commitments and intentions are uncertain and very difficult to gauge upfront. This is always happening even after thorough screening, due diligence activities and evaluations have been carried out.

During the post investment stage and risk management, the relationship between the venture capitalists and the investee firms places the venture capitalists in a place where the moral hazard problem has to be addressed (Yung & Zender, 2010; Jewitt, Kadan & Swinkels, 2008; Elitzur & Gavious, 2003). For instance, the selected firms, each performing in self-interest and having handed over a portion of its holdings in the venture business, are encouraged to limit their effort on the venture business. Thus, the venture capitalists attempt to overcome this through the utilization of the venture financial contract or by other means. This is done by imposing penalties to any investee firms that failed to meet the financial performance targets, creating performance boundaries and decision autonomy limits for the funded firms (Dahiya & Ray, 2012; Leisen, 2012).

It is believed that the venture capitalists may also attempt to influence the funded firms by getting involved directly or indirectly in monitoring their venture business effectiveness, most likely via an efficient flow of strategic information. Besides, it is also commonly accepted that the funded firms or better viewed as the investee firms possess a greater control and familiarity with the business operations than the venture capitalists. This also covers the control over the generation of strategic business information.

For instance, in the case of pursuing self-interest, the funded firms could possibly not telling the complete or actual performance by providing selective information for the purpose of making their venture businesses look favorable. The venture capitalists may respond to this by establishing disclosure laws that guide the easy movement of information between them. Here, it is important to know that the venture capitalists have already set clauses to protect their investment and they are fully prepared to face all the possible problems that may arise before, during and after the financial contract. It is observed that the venture capitalists often function effectively in the enterprise throughout the whole investment stages which reflect their fund providers' interests and to ensure that their invested funds can generate reasonably capital gains and are not at risk.

However, the establishments of disclosure rules and active role imposed by the venture capitalists during the investment stages have been criticized to be insufficient in ensuring the funded firms comply with all the venture capitalists investment requirements and regulations (Leisen, 2012; Bengtsson & Sensoy, 2011; Cumming, 2005). It is cited that the absence of representatives in the funded firms' boards may give great impact to all the venture capitalists endeavors in protecting their investment interests in the funded firms (Pombo & Gutiérrez, 2011; Arosa, Iturralde & Maseda, 2010; Nguyen & Nielsen, 2010; Long, Dulewicz & Gay, 2005).

Furthermore, the venture capitalists are assumed to deal with many other firms in their portfolio, which means that they have limited time to focus directly on one particular investee firm. Only once the problems arise, then more attention is given to that particular firm. Any attempt made by the venture capitalists to deal directly with the problematic investee firm requires them to commit their precious time, efforts and other priceless resources. Moreover, it is observed that the attempts made by venture capitalists to deal directly with their problematic investee firms may have the possibility to end with unfavorable results (Chen, Jin & Yuan, 2011; Duchin, Matsusaka & Ožbas, 2010). At the same time, the venture capitalists also may have missed another good investment opportunity which emerges while they are busy focusing their attention and time to solve the problems in a particular investee firm.

Early insights indicate that the problems and conflict between the principal companies and the firms where they have investment interests (agents) can be moderated through the usage of controlling mechanism by placing a nominee director in the agent firms' board of directors. The study by Andrieu (2013) found that not all the factors in venture capital investment stages contribute to the formation of conflict between the venture capitalists and entrepreneurs. Yitshaki (2008) and Sohaimi (2004) found that the monitoring and supervision efforts conducted by the venture capitalists affect the formation of conflict in venture cooperation. Also, Metrick and Yasuda (2011) on the study of venture cooperation affirmed that there is inconclusive result on the link between venture capitalists and entrepreneurs in their venture cooperation. In a situation like this, Baron and Kenny (1987) and Lucky and Minai (2011) suggested a contingency model in which another variable called a moderator comes to moderate the relationship between the independent and dependent variables for a better explanation of their relationship.

From the broader perspective, in any venture cooperation, conflict between cooperative parties seems to be inevitable and it is very difficult to avoid throughout the venture cooperation investment life. This is confirmed by Mohammad, Minai and Lucky (2014) who found that 24 out of 35 Malaysian venture capitalists or 68.6% of the Malaysian venture capitalists often face problems and conflict with their investee firms. It is the same for the cooperation between the venture capitalists and their agents. Therefore, placing a nominee director in the investee firms' board of directors is viewed to be one of the effective ways to ensure such success. In this case, the placement of a nominee director is aimed to minimize potential conflicts in venture cooperation. It is proposed that besides representing the venture capitalists in a conflict resolution with the problematic investee firm, the nominee director placed is also expected to police the investee firms and at the same time moderating the potential 'blow' of venture relationship between their venture capitalists principal and the investee firm where there is no need for the venture capitalists to get further involved in the unnecessary uncontrollable unfavorable business financial situation.

This is the research issue that becomes the focus in the study. The potential for agents to breach the financial contract is obvious and with the precautious action by the venture capitalists through their contract clauses indicate that they trying to avoid such situation. However, reports and insights show that many agents have failed in fulfilling the contractual agreement and thus this has triggered for the venture capitalists to come out with new measures to have the nominee director in the company.

However, the root of any conflict in any venture capital cooperation is presumed to come from the investee firms themselves rather than from the venture capitalists. The contractual agreement between the venture capitalists and their investee firms prior funding clearly stated the rights and the responsibilities of both parties throughout the venture cooperation life. Therefore, the monitoring and post investment activities conducted by the venture capitalists are subject to what have been stipulated in the contractual agreement. The conflict in venture cooperation exists largely during the post investment stage mainly due to the failure of the investee firms in fulfilling their obligations (Batabyal, 2012; Dahiya & Ray, 2012; Gimmon *et al.*, 2011; Chowdhury, 2009) such as having full information disclosure even though the requirement for this is clearly specified in the contractual agreement. The presumption that the conflict in venture capital cooperation originated from the investee firms behavior is confirmed by many venture capital literature and this is quite hard to be denied.

As stated earlier, this study focuses on the moderating effects of the nominee director on the venture relationship between the venture capitalists and their investee firms. If a conflict arises between the venture capitalists and their investee firms, the venture capitalists need a mechanism to address the problem. One of the mechanisms is the placement of a nominee director in the investee firms' board of directors with the possibility to directly moderate their venture relationship. At the same time, the nominee director can play the monitoring and supervisory roles in that particular firm whilst the venture capitalists can focus on other new investment opportunities and other new business prospects.

To this point, it should be realized that the investee firms' initial status as principal and the venture capitalists as agent has changed based on the situation. As of the time the venture capitalists and the investee firms entered a financial agreement, this has changed the venture capitalists' status to principal whilst the investee firms as agent in the venture capital financing.

In fundamental nature, financial agreement theory posits that management conflict arises while the practice affirms the presence (Bengtsson & Sensoy, 2011; Speakman & Ryals, 2010; Cumming, 2005). When investee firms intend to pursue their private business goals and plan not to comply with the venture capitalists requirements, it is a breach of contract and this shall lead toward the management conflict of the fund provided to the specific financial contracts. If the venture capitalists come to know about the mismanagement, the conflict arises and managing or preventing such situation is very crucial. This implies that a cordial business relationship and the ability to fulfill the venture capitalists' requirements are very important to ensure the success of the venture business. The significance of management conflict in venture cooperation can be seen from the following point of views.

In the organizational perspective, as a result of the information asymmetry between the venture capitalists and the investee firms, management conflict has the potential to rise for two main reasons. Firstly, the conflict arises once the desires and objectives change and the other party does not agree with it. Flexibility and behavior change are common among small firms (Minai & Lucky, 2011) and these small firms tend to behave according to what is best for them at the moment. Thus, for instance if the investee firms are having different objectives on cash flow and profitability of the enterprise that they agreed upon, then they are most likely to be in conflict since both parties may now regard differently on many managerial factors and also other considerations as they work towards the different business objectives, as being changed from the original objective.

Secondly, it is regarding the view on risk and risk sharing. With the change scenario, as the business scenario evolves, the perception on risk change and this may push for different managerial factors and style where both parties may disagree even though some clauses may be stated in the contract. For instance, pertaining to market risk and agency risk where, according to Obrimah and Prakash (2010) and Maula, Autio and, Murray (2009), the venture capitalists may have higher priority on the interest in the market rather than agency risks. Generally, other management conflicts which are unique to this type of business relationship between the venture capitalists and the investee firms may arise, for instance, agency costs, sorting problems and operating costs.

From the financial point of view, there are two major sources for management conflict between the venture capitalists and the investee firms (Rosenbusch, Brinckmann & Müller, 2013). Firstly, Minai and Lucky (2011) and Autore and, Kovacs (2010) highlight the fact that the investee firms will usually make their managerial decisions that will only benefit them directly but do not benefit their venture business economic value as a whole. Secondly, the investee firms are putting less effort and also risk averse in their venture business managerial decision making (De Wit, Jehn & Scheepers, 2013; Tian, 2011). For instance, one of the main disagreement areas is management costs. This includes the costs of screening, evaluating venture proposal, monitoring venture business progress, gaining and exchanging of information and bonding between the venture capitalists and investee firms. For instance, during the information exchange between the venture capitalists and investee firms, the venture capitalists are more likely to require more information on the venture business technological aspects from the investee firms.

Nevertheless, the investee firms are highly likely to refuse providing that particular business information due to trade secret (Batabyal, 2012; Prashantham & Kumar, 2011) and this sometimes being practiced to the venture capitalists. Quietness and lack of information flow lead toward skepticism (Autore & Kovacs, 2010; Chowdhury, 2009) and when questions arise, conflict is potential to happen due to the question of trust (Popov & Roosenboom, 2013; Tsamenyi, Qureshi & Yazdifar, 2013). In this instance, the venture capitalists may spend unnecessary additional cost through additional actions such as legal documentation in order to ensure the investee firms provide necessary information required by them. As for the investee firms, replying and providing feedback involving the legal documentation preparation. Besides, other periodical reports may also incur additional costs to them. Therefore, this suggests that conflict incurs costs and both the venture capitalists and investee firms are to be expected to protect their interest when conflict emerges. In other word, conflict is not good for both party and if it emerges, then something needs to be done or something needs to be done to prevent conflict from occurring.

The placement of a nominee director in the investee firms' board of directors is argued here and expected to have the impact on the relationship between venture capitalists and their investee firms and the solution to the fragile relation if it does occur. Thus, it is contended that the placement of a nominee director in the investee firms' board of directors shall bring positive effects on the relationship that exists when the financial contract between the venture capitalists and their investee firms takes place. It is felt justified to investigate the effect of the nominee director on venture relationship between venture capitalists and investee firms across the full venture capital process.

1.4 RESEARCH QUESTIONS

Whilst the problem statement section reveals several key issues on the potential management conflict between venture capitalists and the entrepreneurs arises from various possible scenario, this section identifies and highlights the research questions for the study.

1. What are the key managerial factors that determine the conflict in the venture relationship when the venture capitalists, provide fund to entrepreneurs? Are the managerial factors identified in the literature pertaining to other sectors fit into this study and the study of the venture capital sub sector? Among others, the following sub research questions are raised:

   1.1 Do deal origination and screening factors contribute to the managerial conflict between the venture capitalists and organizations funded by them?

1.2 Does the evaluation process implemented by the venture capitalists contribute to the managerial conflict between the venture capitalists and organizations funded by them?

1.3 Do contracting and deal structuring process contribute to the managerial conflict between the venture capitalists and organizations funded by them?

1.4 Do monitoring and post investment process contribute to the managerial conflict between the venture capitalists and organizations funded by them?

1.5 Does acquiring liquidity process contribute to the managerial conflict between the venture capitalists and organizations funded by them?

1.6 Do risk management factors contribute to the managerial conflict between the venture capitalists and organizations funded by them?

These questions lead towards the factors that should be reviewed when examining the potential contributors to the potential conflict that may arise when the relationship turns down due to various reasons. Once the contributing factors are being established, the next research question is pertaining to the potential effect of the nominee director to the relationship. The research question formulated is as follows:

2. Do nominee director placements have an effect on the relationship between factors raised earlier and the ways to address the management conflict emerges during financial contract agreement between both parties?

1.5 THE OBJECTIVES OF THE STUDY

The research questions in turn lead to the research objectives or aims of the study. It is as follows:

1. The study attempts to reveal the managerial factors that should be examined whilst addressing the potential management conflict in venture capital financing, which is between the venture capitalists and the investee firms.

2. To determine whether nominee director placements have a significant effect on the relationship between the venture capitalists and their investee firms in venture cooperation.

3. To propose a method to minimize the management conflict between venture capitalists and entrepreneurs in venture cooperation.

1.6 THE SIGNIFICANCE OF THE STUDY

De Clercq and Sapienza (2006) have reported that most of the recent studies propose that venture capitalists and venture backed firms should create mutual and reciprocal relationship based on trust and social exchange. They stated that the studies are regarded to the cooperation between the venture capitalists and venture backed firms, but very limited write ups are available pertaining to the conflict between the venture capitalists and the venture backed firms. This study, as to the author is concerned, the first attempt to examine the issue of management conflict in the venture capital financing and this thus provides the first comprehensive academic and practical insight into this issue in particular when the function of nominee director being studied.

Example studies on the relationship between the venture capitalists and venture backed firms since 1986 include the active monitoring (Hellmann, 1998; Timmons & Bygrave, 1986), the exchanging of information and strategic information (Reid, 1998; Wright & Robbie, 1996), the screening mechanisms employed (MacMillan, Zemann & Subbanarasimha, 1987), the incentives to exit (Black & Gilson, 1998; Berglof, 1994), the proper syndicating of financing (Admati & Pfleiderer, 1994), the staging of actual financing (Sahlman, 1990), the cognitive and management conflict (Sohaimi, 2004; Higashide & Birley, 2002) and the inherent and actual conflicts between venture capitalists and venture backed firms (Yitshaki, 2008). The report by Sohaimi (2004) possibly is the only one newly related to this study.

The study provides insight on the factors contributing to the occurrence of management conflict between the government and local private venture capitalists operating in Malaysia with their investee firms in their venture cooperation. Theoretically, the first objective leads toward the revelation of factors, in partial the managerial factors that potentially contribute to the emergence of conflict between the venture capitalists and entrepreneurs in venture backed firms. This shall be the first attempt to reveal the research model highlighting the managerial factors contributing to the potential conflict between the two parties, of the venture capitalists and entrepreneurs in venture backed firms.

The second objective provides a significant contribution in terms of the function of nominee director in minimizing the conflict if it exists or preventing the potential conflict if the financial terms are violated, that leads toward the existence of management conflict. The findings from this objective show that the nominee director placement gives little or no impact on the relationship between venture capitalists and their investee firms in their venture cooperation. The hypothesis testing for this particular research objective found that the placement of a nominee director in venture cooperation has no significant difference on the relationship between the venture capitalists and their investee firms.

For venture capitalists, the study has helped to create more awareness on the conflict occurred between them and their investee firms. Besides, the findings will also help to guide venture capitalists in the formulation and implementation of policies regarding venture capital financing with special attention given to the prospect firms' full information disclosure requirement prior the evaluation stage. Also, the new methods of controlling the investee firms should also be well addressed by the venture capitalists as the alternatives for the existing controlling tools.

For entrepreneurs (investee firms), the model or framework provided in this study serves as a guide to them in taking more proactive actions in avoiding any major conflict that would harm their relationship with venture capitalists. Well exchange of information is vital in any venture cooperation since it helps both venture capitalists and entrepreneurs to have better opportunities in creating successful ventures. Therefore, entrepreneurs need to develop mutual trust with their venture capitalists and should not refuse their responsibilities to share their information with their venture capitalists as it is seen to be able to aid both parties in creating successful venture businesses.

1.7 ORGANIZATION OF THE THESIS REPORT

The thesis is divided into five chapters. Chapter One of this thesis provides brief explanations on the thesis. It consists of the introduction, research background, problem statements, research questions, research objectives, the significance of the study and lastly about the organization of this thesis report.

Chapter Two provides the review of the literature relating to the conflict in order to clarify the arguments facilitating the development of research questions and research objectives. The chapter provides empirical literature that discusses in details about the conflict and issues arises from venture capital financing and approaches in solving conflict arising from venture capital financing. The roles of nominee directors and how the placement of a nominee director may influence the relationship between the venture capitalists and their investee firms in venture capital financing are also covered in this chapter. Besides, this chapter also provides the review of the venture capital investment activities in Malaysia.

Chapter Three provides explanations of the methodology and procedures being utilized to collect and process data. Firstly, it describes about the research framework development adopted for this study. Then follows with the discussion of the research design sub-topic that provide details about the research site and sources of data, the design of questionnaire as the research instrument for this study and about the data collection and sampling method. Besides the above, this chapter also provides the research hypothesis statements, as well as the data analysis procedures being applied to test the hypothesis statements.

Chapter Four presents the results of the data analysis, response information and summary of the findings of all hypotheses. Finally, Chapter Five discusses the contributions of the research to the body of knowledge and to the practitioners. This includes the discussion on the limitation of the study and also the suggestions for future research in this particular research area. Figure 1.1 illustrates the schematic diagram of the contents of this thesis.

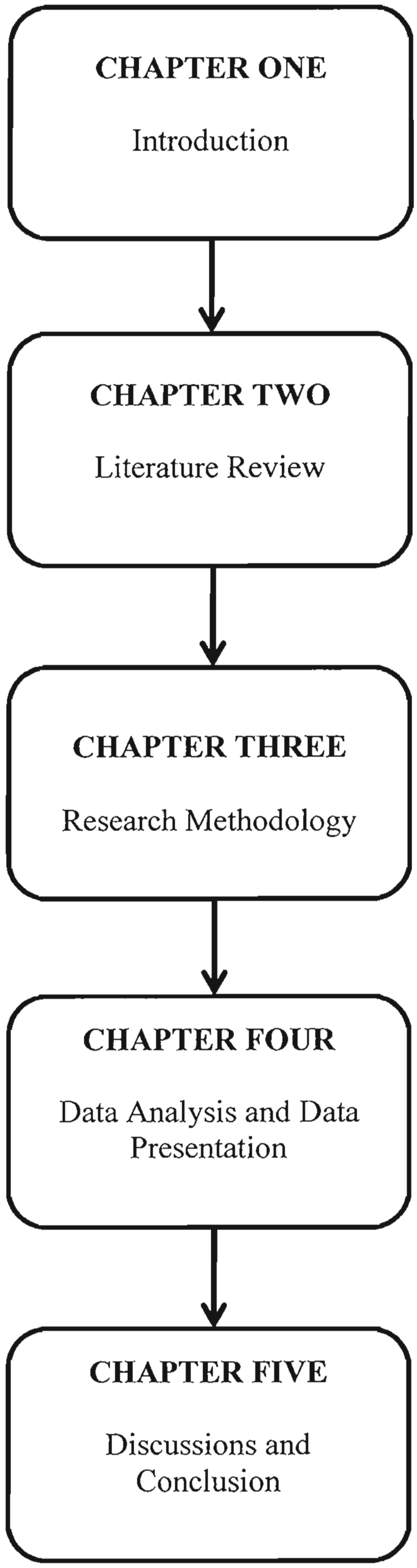


Figure 1.1
Organization of the Thesis

1.8 OPERATIONAL VARIABLES

In this study, several terms are regularly mentioned in the discussions. These terms are defined as follows:

Venture Capitalists

Venture capitalists refer to both government and private initiated venture capital companies. They are incorporated in Malaysia. According to Mohammad *et al.* (2014), besides managing their private venture funds, they also involve in managing funds received from the Government of Malaysia and other related government agencies. Furthermore, Sohaimi (2004) said that their targeted sectors comprise of high impact sectors including information and communication technology (ICT), life science, medical and pharmaceutical, manufacturing and other sub industries that comprise of education, power and trade industries. They operate their businesses in Malaysia.

Investee Firms

Investee firms refer to the firms that locally incorporated and operating in Malaysia. According to Gimmon *et al.* (2011), these firms received funding from venture capital investors. Their business focuses are in the ICT, life science, medical and pharmaceutical, manufacturing and other sub industries that comprise of education, power and trade industries. They operate their businesses in Malaysia.

Venture Capital Investment Process

According to Klonowski (2007), the venture capital investment process represents the stages in venture capital financing. This term covers the complete set of activities in venture capital financing, which begins at the pre-investment stage, post investment stage and risk management. The activities in venture capital financing can be characterized as a methodical procedure which incorporates five successive steps: deal origination/deal generation, deal screening, deal evaluation, deal structuring/contracting and post investment activities, which also include acquiring liquidity and risk management (Mohammad *et al.*, 2014; Klonowski, 2007). The involvement of thorough and lengthy activities implies that due to the high risk of their venture business, both the venture capitalists and the investee firms have to be cautious and strategic in their managerial factors starting from the pre-investment stage, and then following through to the post-investment stage and for risk management (Yitshaki, 2008).

Managerial Factors

Managerial factors refer to the strategic managerial practices and the venture capitalists and investee firms procedures that facilitate or hinder the management and the success of their venture business (Mohammad *et al.*, 2014). In other words, managerial factors relate to venture capitalists and investee firms explicit preferences, significance and applicability of certain managerial procedures and practices in running their venture business. For instance, during the due diligence and screening stage, the venture capitalists may prefer to use their own method in locating and identifying potential firms to be funded. Besides, they also may favor to utilize the third parties independent market reports as one of the key criteria in their evaluation process (Klonowski, 2007; Sohaimi, 2004).

Within the deal evaluation context, the venture capitalists may favor the market and cash-out potential as the key criteria in their evaluation benchmarks. At the other side, the investee firms might have other preferences in terms of the due diligence sources and criteria to be used in the screening and evaluation stage. Therefore, this suggests that both the venture capitalists and investee firms' preferences may be due to their experience in running businesses and their own expertise (Mohammad *et al.*, 2014; Sohaimi, 2004). All of these managerial practices and procedures are vital in the context of reducing management conflict. Other examples of the venture capitalists and investee firms' management factors are given throughout the thesis in the related context of discussion.

Venture Cooperation

According to Mohammad *et al.* (2014), venture cooperation is the business relationship established between the venture capitalists and the investee firms. This cooperation requires both parties to combine their efforts and business resources together in running the venture business they have ventured into. Therefore, this cooperation also requires legal contracts and complete black and white documentation to be employed for the purpose of addressing any management conflict that may occur throughout the relationship (Klonowski, 2007; Sohaimi, 2004).

Management Conflict

Management conflict is the conflicts experienced by the venture capitalists with their investee firms in running together their venture business (Mohammad *et al.*, 2014; Sohaimi, 2004). The term also covers the agency problems or other issues that are difficult to be completely contracted away by both venture capitalists and investee firms. Based on the extant literatures, the cases of management conflict between the venture capitalists and their investee firms can be described in the following context.

Initially, conflicts in goals alignment and verification for their venture business are such as cash flow and profitability objectives and the expenditures on research and development (R&D). Secondly, conflicts in risk sharing are such as the differences in the venture capitalists and investee firms' perception on the agency risks and market. All of these conflicts lead towards an increase in the amount of risks and costs, such as bonding costs, screening costs, monitoring costs and other operating costs associated with it (Gimmon *et al.,* 2011; Yitshaki, 2008).

Nominee Director

This term refers to individuals usually from the venture capital companies' top management personnel, which were appointed to become a nominee director in the firms (investee firms) funded by the venture capital investment (Salim & Yong, 2008). The nominee director major roles comprises of monitoring and to supervise the investee firms operation from various operational aspect (financial, marketing, human resource, strategic management, risk management) in ensuring that the funded firms are comply with the venture capital contractual agreement. The nominee directors are the venture capitalists representative in the investee firms' board of directors.

1.9 CHAPTER SUMMARY

This chapter discusses the problem statement, the research questions, the objectives of the study and the significance of the study. These have become the study's foundations that contribute directly in building the literature review. The related literatures are discussed in Chapter Two.

CHAPTER TWO

LITERATURE REVIEW

2.1 INTRODUCTION

This chapter provides a wealth of understanding and the definitions of conflict as the dependent variable in the study and its consequences. The discussion also includes the conflict handling styles and the empirical literature on both management conflict and venture capital. This chapter examines the body of knowledge and the scholarly contributions relevant to the research problems.

This chapter begins with the discussion on the management conflict. This section discusses the conflict definitions, the types of conflict and also the conflict management styles. This is followed by the discussion on the empirical literature on management conflict.

The next section explains the venture capital investment process. The discussions on this part provide detailed information on the managerial factors, namely, deal origination and screening, evaluating venture proposal, contracting and deal structuring, monitoring and post investment activities, acquiring liquidity and risk management. This is followed by the discussions of the approaches used in solving conflict arises from venture capital financing.

The final section of this chapter provides a detailed discussion on the Malaysia venture capital industry. The discussion on this part includes the analysis on the

Malaysia venture capital industry background and the overall analysis on the Malaysian venture capital investments. The discussions in this section also provide a comprehensive analysis of the Malaysian venture capital sources of funds.

2.2 MANAGEMENT CONFLICT (Dependent Variable, DV)

Management conflict is the conflicts experienced by the venture capitalists with their investee firms in running together their venture business. The term also covers the agency problems or other issues that are difficult to be completely contracted away by both venture capitalists and investee firms. Based on the extant literatures, the cases of management conflict between the venture capitalists and their investee firms can be described in the following context.

Initially, conflicts in goals alignment and verification for their venture business are such as cash flow and profitability objectives and the expenditures on R&D. Secondly, conflicts in risk sharing are such as the differences in the venture capitalists and investee firms' perception on the agency risks and market. All of these conflicts lead towards an increase in the amount of risks and costs, such as bonding costs, screening costs, monitoring costs and other operating costs associated with it (Gimmon *et al.,* 2011; Yitshaki, 2008).

A theory is a hypothesis that has been confirmed by observation, experiment and is propounded or accepted as accounting for the known facts (Curi, 2012; Haugh, 2012; Wacker, 1998). In other words, theory also refers to a statement of what are to be held as general laws, principles or causes of something known or observed. In the past, many theories have been used in researches in explaining the interaction among factors and determinants that caused conflict between two or more parties.

The Theories of the Firm are widely used in the management studies in explaining the nature of a firm, its existence and behavior, its structure and also its relationship to the market. The theories consist of a number of other economic theories. Hence, it is a broad theory and the way it is used and viewed depends on from which perspective a firm is being studied. Theories of the Firm are conceptualizations on business enterprises that explain the structure it concerns primarily with predicting the behavior of firms, particularly with the external markets (Cheng, Tsai & Chuang, 2011). Lee (2010) said, although economists use the term theory of the firm in its singular form, there is no single and multipurpose theory of the firm. For instance, the every theory of the firm is pertaining to the abstraction of the real world business enterprise. It is designed to address certain characteristics and behaviors of the enterprise. In fact, there are a number of theories related to the theories of the firm and these theories are complete in providing explanations of the same phenomena. It is also true they complement one another in explaining different phenomena (Parker & Castleman, 2009).

According to Manral (2010) and Key (1999), the causal explanation for this theory is the market forces and the rationality underlying them. Key (1999) further said, in the neoclassical theory, the goal of the Theory of the Firm is to maximize the wealth of the firm and is based on contractual duties owed to owners. Thus, for the neoclassical theory of the firm, it seems to assume that the duty of the firm is financial. Owners are responsible for this duty. In the modern day, the stockholders are those who are responsible in the case of modern corporation. Due to the theory's original underlying assumptions, the Theory of the Firm has been called for revision for a renewed attention (Gindis, 2009). The theory should be looked at from the perspective of firms' resources, capabilities and competence instead of solely focusing on the monetary objectives as what the theory originally proposed (Ruester & Neumann, 2009; Niman, 2008; Montresor, 2004).

Sohaimi (2004) in his study on management conflict in venture capital financing has used the Theory of the Firm to explain the interaction between several determinants that caused management conflict in venture cooperation. Due to the theory's underlying assumptions, the perspective of this theory had been viewed from the perspective of; (1) capital investment, (2) separation of ownership and (3) control and corporate strategy in an attempt to explain the management conflict in venture cooperation among Malaysian venture capital operators and venture backed firms. These views are argued necessary in explaining the occurrence of management conflict in venture cooperation. For instance, separation of ownership and control is a critical concept which can explain the root of the agency problem. He argued that there will always be the opportunities for them to have opportunistic interests.

The use of the Theory of the Firm by Sohaimi (2004) was also being complemented by the two other theories, (1) the Stakeholder Theory and (2) the Agency Theory. The use of these two theories is argued necessary as the explanation on the management conflict in the firm must be supported by these two related theories. Moreover, Baudry and Chassagnon (2010) believe that it is appropriate to explain the interaction between factors that caused the management conflict in venture cooperation.

The Stakeholder Theory, for instance, is needed due to its capacity in explaining the relationship of the firm to its external environment (Alsos, Hytti & Ljunggren, 2011; Luoma-aho & Paloviita, 2010; Co & Barro, 2009). Moreover, it is particularly obvious for explaining the behavior of the stakeholders in a specific environment. The Stakeholder Theory is normally being used in the firm's objectives setting which will help the firm's management to navigate the firm's future direction. Besides, it is also used in managing the function of the firm's strategic management. The theory suggests that there are numerous groups which are influenced and affected by the firm's actual performance (Mainardes, Alves & Raposo, 2011; Orij, 2010). On the other side, the Agency Theory is vital in explaining the root of the agency problem in venture cooperation since both venture capitalists (financiers) and the entrepreneurs (venture backed firms) are separated in terms of ownership and control (Zu & Kaynak, 2012; Mustapha & Ahmad, 2011; Whipple & Roh; 2010). Thus, chances for having opportunistic interests between them are considered high.

Basically, the Stakeholder Theory is a competing theory (Mainardes *et al.*, 2011). Freeman, who proposes the Stakeholder Theory in 1984 believes that there is a relationship between the firm and its external environment. The phenomenon that Freeman attempts to explain is the relationship of the firm to its external environment, and its behavior within this environment. The success of Stakeholder Theory, if being viewed from both management literature and business practice, is due the large part to the simplicity inherent in the model (Evans, Haden, Clayton & Novicevic, 2013).

The Stakeholder Theory has become one of the popular theories in complementing the Theory of the Firm in management studies. The application of the theory can be seen when it was used by Tse (2011) in the debate of the value of both shareholder and stakeholder theories following the recent financial crisis. As mentioned by Pesqueux and Ayadi (2005), this theory helps to enhance a relational model of the organization by revisiting a number of questions regarding 'who' is actually working in the firm. Pesqueux and Ayadi (2005) further stated that the Stakeholder theory is part of a bigger and comprehensive project that views the relationship between an organization and group as a foundation and norm.

The extent of the Stakeholder Theory was then was expanded by Co and Barro (2009) when this theory is used as a platform to provide a framework in analyzing stakeholder management strategies within the context of supply chain collaboration. In the attempt to widen the Stakeholder Theory's concept, Luoma-aho and Paloviita (2010) used this theory by including non-human influences to describe the complex corporate environment. For Zsolnai (2006) he proposed the inclusion of nature, society and future generations in the theory. He said it is based on the premises that all stakeholders are morally considerable and need to be accounted for in the theory.

For Byrd (2007), this theory has been extensively employed to understand its roles in developing sustainable tourism. Orij (2010) uses this theory to investigate whether the corporate social disclosure levels relate to the national cultures. Bourne (2011) needs this theory to provide a framework for assisting individuals in organizations to understand how to engage their senior stakeholders where Jurgens, Berthon, Papania and Shabbir (2010) and Polonsky (1995) use it to design an environmental marketing strategy. In providing further confirmation on how this theory has been used intensively, the following cross references are provided as the evidence:

i. Bornsen, Blonigen and Plowman (2008) use it for corporate strategies examination,
ii. Ihlen and Berntzen (2007) use it to improve and support other theory,
iii. Law (2011), use it to examine the audit regulatory framework in serving the legitimate interests of stakeholders,
iv. Ten (2007), use it to analyze corporate environmental behavior,
v. Reid (2011), use it for event organizing,
vi. Grinstein and Goldman (2011), use it to address management dilemmas,
vii. Frow and Payne (2011), use it to explore value propositions in the context of Service-Dominant logic, and
viii. Mahadeo, Hanuman and Soobaroyen (2011) and McDonald and Lai (2011), use it to investigate the preference of retail banking customers and its impact on customers' attitude and behavioral intentions.

For the Agency Theory, Tate, Ellram, Bals, Hartmann and Valk (2010) highlight that this theory has received a lot of attention from researcher and is widely used in various studies to explain the conflict due to the opportunistic behaviors of different parties in their agency relationship. The use of Agency Theory is evident from the following facts:

i. Ibrahim, Uddin, Taufil Mohd and Minai (2013) and Aripin, Tower and Taylor (2011) have used it to examine the extent of financial ratio communication from an agency theory perspective,

ii. Chitnomrath, Evans and Christopher (2011) have used it to investigate the role of key corporate governance mechanisms in determining a firm's post-bankruptcy performance following reorganization,

iii. Mustapha and Ahmad (2011) have used it to investigate the effect of managerial ownership in relation to agency theory in the Malaysian business environment,

iv. Lee and Chen (2011) and Huang, Huang and Chen (2004) have used it to examine the relationships among chief executive officer (CEO) compensation, ownership and firm value,

v. Zeng and Lin (2006) have used it to examine the effect of ownership concentration, inside ownership and state ownership on the R&D spending practices,

vi. Harada and Nguyen (2011) have used it to investigate the effect of ownership concentration on dividend policy, and

vii. Greco (2011) has used it to investigate the determinants of board and audit committee meeting frequency.

Despite a good number of studies that used the above mentioned theories, the number of research on conflict from the financial perspective that used the above theories, especially in the aspect of venture capital financing is still considered very small (Gimmon *et al.*, 2011; Yitshaki, 2008; Sohaimi, 2004). This has given impacts on the theory building process in this research area. The lack of theory on conflicts between venture capitalists and entrepreneurs is being discussed by academician and is highlighted by Yitshaki (2008). Thus, it is argued here for the need to consider the three theories being discussed earlier to assist in the theory building process to understand the management conflict between the venture capitalists and the entrepreneurs.

2.3 CONFLICT WITHIN THE CONTEXT OF VENTURE AGREEMENT

Traditionally, conflicts arise from different interests and objectives involving resources and goal divergence from the result of frustration (Avgar, 2010; Speakman & Ryals, 2010; Tjosvold, 2006). Conflict can be viewed as the condition in which the needs of more than two parties appear to be incompatible (Montes *et al.*, 2012). According to Parayitam, Olson & Bao (2010), it is the competition between interdependent parties and these parties perceive they have incompatible needs, goals, desires or ideas. This is a situation in which people do not agree or have harmony with one another.

Barron, Kaiser and Pradhan (2009) look at conflict as a common facet of everyday human lives. It is seen as a perceived incompatibility of multiple interests. There are various factors contributing to the formation of conflict, such as goals and motivations misalignment or opposing actions between two or more parties. They also suggest that conflict can be real or only perceived to exist. According to De Wit *et al.* (2013) and Kaushal and Kwantes (2006), conflict can exists in many domains of lives in the form of:

(i) different opinion,

(ii) harsh words, or

(iii) direct action in resolving competing goals.

According to Paletz, Schunn and Kim (2013) and Tagar, Federico and Halperin (2011), conflict is always viewed from the negative perspective, the conflict itself may also lead towards both positive and negative outcomes. In most of the cases, conflict is perceived by many people as the root of disagreement. Besides, it is also being associated with negative emotions and inappropriate behavior. This is common even though the performed behavior was aimed to yield positive outcomes (Ayoko, Konrad & Boyle, 2012). As more people are moving towards maximizing the positive aspects of conflict, it is crucial to put more efforts toward minimizing the conflict negative aspects. Thus, this should prevent the conflict implications from harming the family, children, school, neighbors and work environments as well as the overall community as a whole.

According to Reuver and Woerkom (2010), conflict handling refers to a party's action based on a conflict experience. Whenever a party starts to act and react to certain issue, conflict may occur and such action (conflict) can be viewed as a dynamic process or complicated process. This is evidenced when lose parties try to influence each other in various circle of action and reaction. Randeree and Faramawy (2011) propose the way to look at conflict as one party has been negatively affected or about to be affected as the result of another party's action. The key point to be highlighted here is that the common similarities between various definitions given are related to incompatibility and differences perceived between the parties involved (Nair, 2008).

Basically, conflicts may occur because of a variety of factors. For example, individual differences in goals, values, expectations, proposed courses of action and suggestions about how to best handle a situation that are unavoidable. When these differences are gathered together, the unease negative feeling by any party involved shall lead to the occurrence of conflict (Oh, Kim, Kim & Choo, 2010; Darling & Walker, 2001). This is evidenced when Sohaimi (2004) in his study of conflict in venture capital financing said that the conflict in venture cooperation occurred due to the existence of differences between the entrepreneurs and venture capitalists in terms of their expertise and knowledge. The differences in these aspects have led each party to focus their act based on what they really expert and believed. Thus, resulted both venture capitalists and entrepreneurs to feel discomfort and negatively affected between each other, which finally gave the opportunity for conflict to occur in their venture cooperation.

However, Speakman and Ryals (2010) propose that conflict is a broad construct and has been studied extensively across several disciplines and social scopes. Boonsathorn (2007) proposes four levels of conflict and it is summarized as follows. This is with regard to human behavior and relationship:

(i) Intergroup conflicts between groups of individuals. This can range in size and complexity because of the many relationships involved, for example, international conflict between nations.

(ii) Intragroup conflicts arising within smaller groups in the organization. This can even cover the interorganizational level.

(iii) Interpersonal conflict refers to the conflict that seems at an individual level. In other words, the conflict between individuals.

(iv) Intrapersonal conflict on a personal level. This refers to the internal conflict or conflict in one's own mind.

It can be seen that these four levels of conflict appear across the psychology and management literature. Of all these four levels of conflict, the third level, which is the interpersonal conflicts has become the main research focus of many researchers within the context of an organization (Posthuma, 2011). Ito and Brotheridge (2012) proposed a simplified definition of interpersonal conflict as the process which begins when an individual or group feels negatively affected by another individual or group.

Conflict comprises of a perception of hurdles to attaining one's objectives and goals (Ito & Brotheridge, 2012). According to Nguyen and Yang (2012), and Rispens, Greer and Jehn (2007), interpersonal conflict has recently been defined as differences in views or interpersonal incompatibility and individual's perceptions of incompatibilities. Conflict at this level has mostly been seen as adversarial and as having a negative effect upon relationships (Parayitam *et al.*, 2010). Posthuma (2011) and Boonsathorn (2007) suggested three dimensions of conflict:

(i) content,
(ii) relational, and
(iii) situational.

Posthuma (2011) suggests that the content dimension to include the conflict types such as affective and cognitive relationship, whereas the relational dimension to include the subjective and perceived variables. This includes the dimension of:

(i) trust,
(ii) status,
(iii) seriousness,
(iv) degree of interdependence,
(v) record of success, and
(vi) the number of actors involved.

Boonsathorn (2007) uses and considers the situational dimension by including the variables which are most relevant in selecting the appropriate conflict management strategy. These variables include time pressure, the potential impact of the conflict episode, the escalation degree and the range of options available in managing conflict experience.

According to Rispens *et al.* (2007), conflict is not always destructive in nature. In such circumstances, conflict may also act as a stepping stone or a platform for the conflicting parties to allow them to achieve better performance and yielding good decisions. Such discussions and debates between the conflicting parties may improve their decision making and the quality of the outcomes as well. Conflict is unavoidable in groups and organizations (De Wit *et al.*, 2013; Croucher *et al.*, 2011). This is due to the sense that more people in groups will add more differences among them. Thus, resulting in different courses of actions and opinions and this eventually will lead to the occurrence of conflict.

2.3.1 The Types of Conflict

The broad area of intraorganizational and interpersonal conflict has been further subdivided into two types, which are:

(i) the relationship conflict, and
(ii) the task conflict.

According to Ul Haq (2011), and Reid, Pullins, Plank and Buehrer (2004), the relationship conflict arises between the actors through their subjective emotional positions and the task conflict relates primarily to the more objective tasks and issues involved. A series of studies has confirmed this duality between relationship and task. For instance, Yang and Heeman (2010) identified people oriented versus task oriented conflict whilst Sarpkaya (2012), Rispens *et al.* (2007), and Priem, Harrison and Muir (1995), revealed relationship and task as the discrete aspects of conflict.

In organizing and looking back at how experts define conflict, in 1995, Amason, Thompson, Hochwarter, and Harrison redefine conflict types as affective and cognitive and in 1999, Janssen, Vliert and Veenstra further redefine these types as task and person conflict. Thus, Liu, Chen, Chen and Sheu (2011) argue that conflict has long been a focus of organizational and team research. This is evidenced when many recent researches have investigated the different effects of conflict by differentiating conflict into the mentioned two types which are the task conflict and the relationship or interpersonal conflict (Liu *et al*., 2011; Huang, 2010; Inoue & Kawakami, 2010).

According to Huang (2010), task conflict refers to the opposing views of the team members towards the task. This includes viewpoints, thoughts and ideas. In relationship conflict, it is seen as interpersonal incompatibilities. De Wit *et al.* (2013) suggest that this typically includes tension, animosity and annoyance. The negative responses such as anxiety, affiliation and hatred emerge from the relationship conflicts and it affects the performance of people, lowering their efficiency and reducing the performance. However, other views indicate that task conflict can help members to express different ideas, clarifies concepts and unify goals (MacMillan, Chen, Richard & Bhuian, 2012; Amason & Sapienza, 1997). This leads towards enhancing team performance rather than the negative results highlighted earlier.

Conflict is not without drawbacks. It is important to note that the task conflict has a high relationship with relational conflict. For example, study by Schäfer and Steger (2013) shows that the correlation between these two forms of conflict reached 0.17 to

0.88, whereas Madera, Dawson and Neal (2013) provide an average correlation of 0.54 (adjusted reliability). Thus, efforts to stimulate task conflict in order to obtain the benefit of it may run into a substantial risk of triggering detrimental relationship conflict. Moreover, Madera *et al.* (2003) highlighted that task conflict had a more negative association with a team performance when task and relationship conflict were strongly correlated than otherwise.

Huang (2010) suggests looking into the factor of disposition of team members in examining the relationship between task conflict and relationship conflict. He suggests that when confronting task conflict, team members shall interpret the conflict differently. It is based on their goal orientation and those with different goal orientations shall have different responses to task conflict. This thus shall increase or decrease the linkage between the two types of conflict.

Parayitam *et al.* (2010) and De Wit *et al.* (2013) provide two possible explanation on why task conflict consistently results in relationship conflict. The first argument is that task conflict drive towards relationship conflict through a process of misattribution or misinterpretation. When the attribution process points towards personal attack, task conflict will then triggers relationship conflict through a process of biased information processing and personal interest. Here, it is argued that the disposition of team members is affected by the attribution process. This is where the relationship conflict arises.

According to Keys, Conley, Duncan and Domina (2012) and Dupeyrat and Mariné (2005), the Goal Orientation Theory proposes that, "*during the motivation process of* *learning, an individual with different internal goals is likely to follow different learning strategies, leading to different learning outcomes*". Other researchers such as Lee, McInerney, Liem and Ortiga (2010) argue that goal orientation affect self-regulation activities and thus when someone faces certain task conflicts, one should expect that one with different goal orientations will have different interpretations (self-regulation) and will respond to task conflict differently. According to De Wit *et al.* (2013), this will affect the linkage between task conflict and relationship conflict.

De Wit *et al.* (2013) and Kotlyar, Karakowsky and Ng (2011) highlight the second mechanism in the linkage is inappropriate behavior. In the process of task conflict, there will be someone who is going to feel bruised, humiliated, or offended by the debate tactics or conflict management approaches (self-regulation tactics). This again shows how such end-up in relationship conflict.

2.3.2 Conflict Management Styles

According to Montes *et al.* (2012), who define conflict as the interaction of interdependent people who perceive opposition of goals, aims and values propose that others interfere the other party as potentially with the realization of their goals. Consequently, conflict can be viewed as an important element of social interaction. In fact, conflict always exists and co-exists in every organization. Speakman and Ryals (2010) and Rahim (2002) highlight that no group or organization is free from conflict. Within the context of conflict handling strategies, it is very important to maintain almost all human relationships with regard to personal or working life. The style of conflict management should be looked from the general view and with a consistent orientation toward other people and the conflict issues. According to Posthuma (2011), it is manifested in observable behaviors, whereas Huang (2010) defined conflict management as how individuals or team members deal with the conflict situation.

At the interpersonal level, a number of resolution strategies to be utilized in conflict situations have been identified. For example, Sternberg and Dobson (1987) identified seventeen strategies whereas Rahim and Bonoma (1979) identified five strategies. Outlining a set of strategies that are used to resolve conflict, Sternberg and Dobson (1987) classified the strategies within the context of economic action, physical force, wait and see, stepping down, acceptance, undermining esteem, third party, withholding, compromise/bargain, giving in, avoidance, manipulation, verbal force, prior history, confrontational discussion, mutual discussion and separation.

Montes *et al.* (2012) have highlighted that conflicts can be managed in a variety of ways. Looking back at the history, in the early 1920s, Follet (1942) mentioned that the style of conflict handling as domination, compromise, integration, avoidance and suppression. Then, Deutsch (1949), proposed a dichotomy involving either cooperation or competition. If one is looking for the conceptual approach, then the work of Blake and Mouton (1964) is the first conceptual scheme for classifying conflict styles. They identified five modes of handling conflict:

(i) forcing,

(ii) withdrawing,

(iii) smoothing,

(iv) compromising, and

(v) problem solving.

The Blake and Mouton Managerial Grid suggests that a conflict should be managed in the above five different ways depending on whether the persons involved, have high or low concern for either production or people.

Figure 2.1 illustrates the original Blake and Mouton (1964) Managerial Grid. The model is a behavioral leadership model. It is developed by Robert R. Blake and Jane Mouton in 1964. Originally, the model identified five different styles of leadership. These five leadership styles were based on the concern for production and the concern for people. The optimal style of leadership in this model is based on Theory Y.

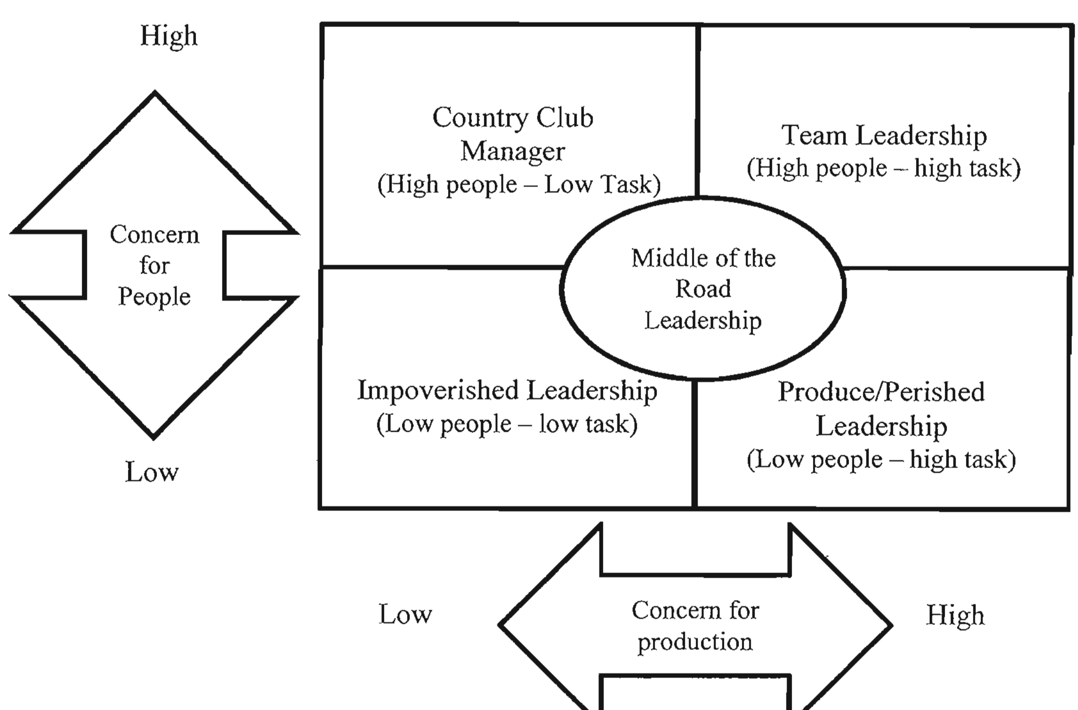


Figure 2.1
The Blake and Mouton Managerial Grid
Source: Blake and Mouton, 1964

Fundamentally, the Managerial Grid is based on two behavioral dimensions:

Concern for People – It is the degree to which a leader considers his/her team members' needs. The consideration also includes the team members' interests and their personal development areas at the time he/she determine the best way to complete a given task.

Concern for Production – It is the degree to which a leader stresses on solid goals, high productivity and organizational efficiency at the time he/she determines the best way to complete a given task.

Based on the Managerial Grid model, Blake and Mouton defined the following five leadership styles by plotting the axis based on "*concerns for production*" and "*concerns for people*":

(i) Country Club Leadership – High People/Low Production

A leader using this leadership style is concerned most about the feelings and needs of his/her team members. A leader that uses this leadership style holds the principle that the team members will work hard and willing to go for extra miles as long as they are happy and feel secure. This style of leadership will result in a relaxed and fun working environment. However, the production may suffer due to the lack in control and direction.

(ii) Produce or Perish Leadership – High Production/Low People

A leader using this leadership style is also known as the Authoritarian or the Compliance Leaders. A leader that uses this leadership style believes that employees are simply to be fully utilized to an end. Therefore, the highest priority is always given to the need for creating an efficient and productive workplace rather than fulfilling the employee needs. An Authoritarian leader is very autocratic. Besides, he/she also has strict working regulations and stringent working policies and procedures. He/she also views punishment to be the most effective mechanism in motivating his/her employees.

(iii) Impoverished Leadership – Low Production/Low People

A leader using this leadership style is said to be mostly ineffective. This type of leader tends to create systems to complete the work and at the same time attempt to create a satisfying and motivating working environment. Consequently, this style of leadership will result in the creation of disorganize, dissatisfy and disharmony workplace.

(iv) Middle-of-the-Road Leadership – Medium Production/Medium People

A leader that belongs to this style of leadership is always attempting to balance the two competing concerns in his/her leadership style. At first, it seems to be ideal to be compromise. However, when a leader compromise, he/she will have to give away a bit of each concern to allow neither production nor people need to be fully met and fulfilled. A person that uses this style of leadership normally will have average performance. Besides, he/she often believes that this is the result that most people can anticipate.

(v) Team Leadership – High Production/High People

Based on the model's diagram, this style of leadership is said to be the high point of the managerial style. A person that uses this leadership style is giving the same level of priority on both the production needs and the needs of his/her team members. The principle applied to this leadership style is that employees are involved in understanding the objectives of their organization and their organization production needs. Hence, once the employees have started to give their commitments to achieve the objectives, and have a stake in the organization's success, their needs and the organization production needs harmonized. This style of leadership creates a team work environment which is based on trust and respect. This will lead towards high satisfaction and motivation among the employees, which may lead to high organization productivity.

The Blake and Mouton's two-dimensional typology has been reinterpreted by many researchers since it was first introduced in 1964. Some of these reinterpretations are as follows:

(i) Boonsathorn (2007) has reinterpreted the model concerning for work relationship and personal goals,

(ii) Ma, Lee and Yu (2008) have reinterpreted the model from the perspective of cooperativeness and assertiveness, and

(iii) Park and Park (2008) have reinterpreted the model based on others and own interests and outcomes.

Based on the reinterpretations done by many scholars and researchers, it is found that most of them preferred to conceptualize the model due to the empirical evidence the model provides (Ma *et al.*, 2008; Rahim, 2002; Rahim, Antonio, Krumov & Iileva, 2000). Their reinterpretation on the model centered on the "*concerns for production*" and the disputants as "*concerns for self and others*".

The first one, which is "*concern for production*" explains on how far a person is willing to go to fulfill his/her own needs and concerns, whereas the "*concern for self and others*" explains on how far a person is willing to go to fulfill the concerns and needs of other people. According to Rahim (2002), Rahim *et al.* (2000), Rahim (1983) and Rahim and Bonoma (1979), the combination of these two dimensions results in five different styles of leadership. These five leadership styles are shown below:

(i) integrating,
(ii) obliging,
(iii) dominating,
(iv) avoiding, and
(v) compromising.

Rahim and his colleagues' works on the reinterpretation of the Blake and Mouton Managerial Grid have further allowed the above five leadership styles to be conceptualized to become five different strategies in managing conflict. These five conflict management strategies are shown below:

(i) integrating,

(ii) obliging,

(iii) compromising,

(iv) dominating, and

(v) avoiding.

The above five conflict handling styles as proposed by Rahim and his colleagues have become the basis for the development of the Rahim Dual Concern Model which demonstrates various styles in handling interpersonal conflict. Figure 2.2 shows the Rahim (2002) Dual Concern Model for styles in handling the interpersonal conflict.

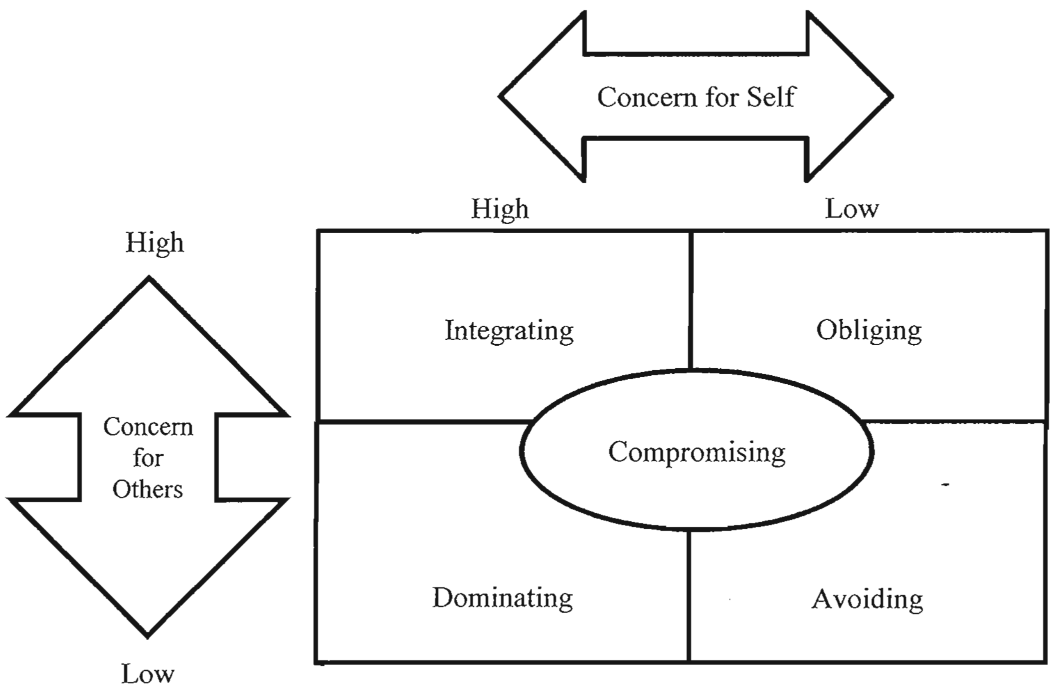


Figure 2.2
The Rahim (2002) Dual Concern Model of the Styles of Handling Interpersonal Conflict
Source: Boonsathorn, 2007

Further explanations and discussions for each of the above conflict management styles are as follows:

(i) **Integrating** (high concern for self and others). Individuals that use this conflict handling strategy shall demonstrate cooperative behaviors between each other in searching for mutually favorable solutions (Wang, 2012). Conflicting parties that use this conflict handling strategy should concentrate on sharing their goals and points rather than pursuing their own personal interests. Furthermore, conflicting parties should also involve in conflict solving by working through the conflict using creativity, flexibility and open communication and information exchange. These are necessary for them to achieve the best solution for all concerned parties.

(ii) **Obliging** (low concern for self and high concern for others). This conflict handling strategy is recognized by its imperfect evaluation on alternatives and a one-sided process of giving which result in the decisions made to be inferior (Koc, 2010). A person who chooses this strategy will normally giving up his or her own concern in order to satisfy the other party's concern. This conflict handling strategy is recognized by such actions like totally following other peoples' decisions, agreeing on the decisions made without having critical evaluation and giving in to others' positions.

(iii) **Dominating** (high concern for self and low concern for others). This conflict handling strategy is recognized by its win-lose orientation or with such aggressive and forcing conduct with the main purpose of dominating other party's position. This conflict handling strategy involves in the use of a confrontational tactic which may lead towards one party to concede to other conflicting parties. According to Mura, Bonsignore and Diamantini (2010), this strategy is normally involved in the use of various offensive tactics to resolve the conflicts occurred. These offensive tactics include directive communication about the problem, tireless argument for one's own particular position and an attempt to dominate the interaction between the conflicting parties.

(iv) **Avoiding** (low concern for self and others). This conflict handling strategy is characterized by the behavior that helps to reduce the conflict potential explicitly. This is achieved by either quickly changing the conversation topic or ignoring any situation or conversation that have the potential to spark a conflict. This conflict handling strategy is recognized by such action, for instance withdrawal from continuing the arguments with the other conflicting parties to avoid any conflict from occurring (Rahim, 2002).

(v) **Compromising**. This conflict handling strategy is said to be in the central of the dimension across concern for self and concern for the others. Individuals that use this strategy will normally show modest interest in pursuing a mutually acceptable outcome. However, this is achieved without making a concerted effort to reach it. Therefore, both conflicting parties may have some gains and some losses due to the needs to give-and-take. This is where both parties giving up some of their important needs or goals since they realized that some suboptimal result should be accepted (Boonsathorn, 2007). This strategy is often used by individuals when their willingness to solve the conflict is not sufficiently high. Besides, it is also used once the conflicting parties are facing pressures due to the time and cost constraints. This strategy involves the use of such tactics like appealing to fairness, maximizing wins and minimizing losses, suggesting for a trade-off and offering a fast and short-term solution.

The conflict resolution styles discussed above are based on the Blake and Mouton Managerial Grid (1964) that demonstrates different approaches in handling a conflict. Even though the conflict handling strategies discussed above are usually applied in the organizational context, it is also possible to generalize the strategies to any situations that involve interpersonal interactions.

According to Huang (2010), conflict can happen at both the intergroup and interpersonal levels due to various reasons that may range from social to personal. From the social level perspective, cultural variables may have the effects that could influence the way a person approaches a social interaction, the way an individual perceives the situation and the method in which one chooses to resolve this situation (Croucher *et al.*, 2011). According to Kaushal and Kwantes (2006), the similar situation could also result in entirely different responses within one society than another. Previous researchers have utilized various tools to capture the conflict management styles in both the interpersonal and organizational contexts. Even though there were many conflict management models and instruments were used, the Rahim (1983) conflict handling model seems to be the one that received lots of attention in many academic discussions pertaining conflict management styles.

According to Boonsathorn (2007), even though conflict appears to be a common phenomenon in human lives, it is believed that each person deals with it in a different way. In a variety of studies regarding conflict, the way in which people manage it has received a great deal of attention. Styles of conflict management are characterized by the general tendency for an individual to display a certain type of conflict behavior repeatedly and across situations (Posthuma, 2011). Because of reliance on certain styles more than others, conflict-handling styles are viewed as relatively stable personal dispositions or individual differences (Ayoko *et al.*, 2012; Boonsathorn, 2007). Even though many researchers believe that people have preferences for certain styles, that does not mean that they also feel that people use only those styles in every conflict situation they encounter. According to Ayoko *et al.* (2012), individuals also may adopt and enact other styles of conflict management, which they thought to be suitable and appropriate based on the conflict situation they faced.

2.4 EMPIRICAL LITERATURE ON MANAGEMENT CONFLICT

According to Nair (2008), conflict has traditionally been viewed as something to be avoided and bring negative implications to the parties involved. Nair further said, at the beginning, most scholars suggested that conflict is detrimental to the performance of the organization and should be avoided. However, as the studies in this area developed, a new perspective of conflict was born when modern theory scholars have started to view conflict as something beneficial instead of detrimental (Ayoko *et al.*, 2012; Tjosvold, 2006). The literature on conflict has seen a move from a purely collaboration-based approach to a more contingent view of conflict management over time (De Wit *et al.*, 2013; Paletz *et al.*, 2013).

According to McKenna (1995), the conflict itself is a process. Conflict begins when one party perceives that the other has frustrated, or is about to frustrate, some concern about his/her. Concerns here are defined as the needs, wants and values of an individual. Therefore, conflict situations arise when the needs, wants and values of two parties interfere with one another. McKenna (1995) further said conflict may not be harmful, depending on how the parties react to present opportunities for situations to be driven forward effectively, particularly in business contexts.

According to Robbins (2008), there are five stages in a conflict process as shown in Figure 2.3. The five stages of conflict comprise of:

(i) Stage 1 – Potential opposition or incompatibility

(ii) Stage 2 – Cognition and personalization

(iii) Stage 3 – Intentions

(iv) Stage 4 – Behavior

(v) Stage 5 – Outcomes

The first stage (Stage 1) in a conflict process begins once someone is negatively affected by other people or started to feel incompatible with other peoples' needs, stands, values and actions. This incompatibility feeling then escalates to cognition and personalization stage (Stage 2) when conflicting parties started to realize and felt that they are having conflict with other people or parties. The conflict awareness will further stimulate the intention of the conflicting parties to react accordingly to the occurred conflict through the selection of conflict handling intentions (Stage 3). This is the stage where conflicting parties started to decide whether they are going to compete, collaborate, compromise, avoid or accommodating between each other in response to the occurred conflict. In other words, this is the stage where conflicting parties attempt to handle and manage their conflict. The decision made by conflicting parties then will be translated into behavior or action (Stage 4) before the outcomes can be yielded (Stage 5).

These five stages conflict process support the conflict definitions given by many scholars in academic literatures when it clearly stated that conflict begins with incompatibility, as perceived by the conflicting parties (Cerni *et al.*, 2012; Giacomantonio *et al.*, 2011; Doucet, Poitras & Chenevert, 2009; Humphreys, Williams & Goebel, 2009). Basically, there are various determinants for the conflict management style adopted by the conflicting parties. Ozkalp *et al.* (2009) found that status is one of the factors that influence the conflict management style among conflicting parties. In his study on management conflict between Turkish managers, Ozkalp *et al.* (2009) also found that most of the Turkish managers prefer to integrate and compromise instead of competing and avoiding in dealing with conflict with other parties and the decision to use either style is strongly influenced by the managers' status.

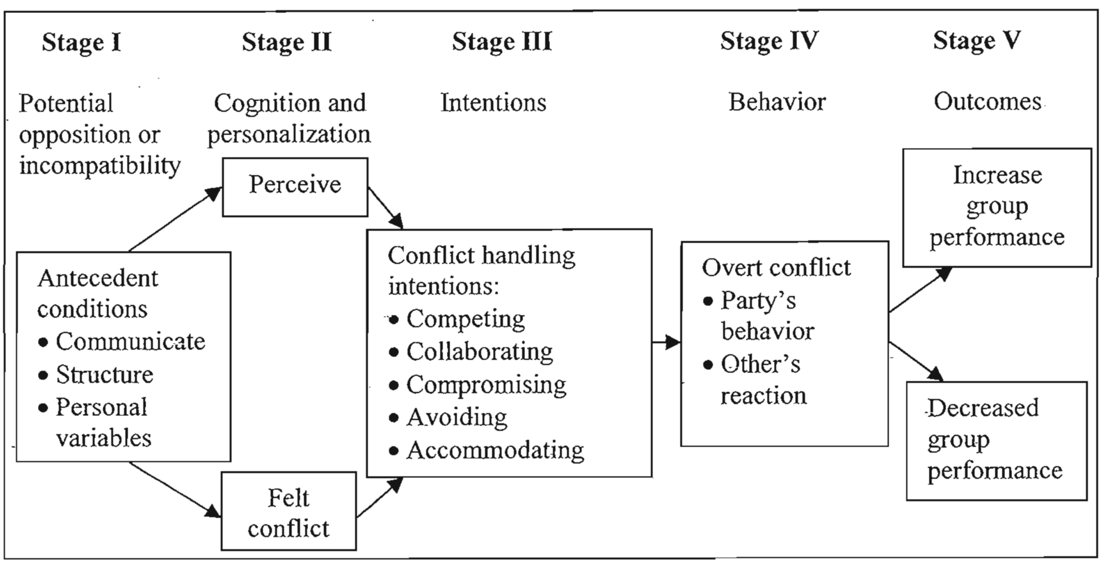


Figure 2.3
Five Stages in Conflict Process
Source: Robbins, 2008

On the other hand, cultures are also said to strongly influence the conflict management styles among individuals (Kim *et al.*, 2007; McKenna, 1995). Kim *et al.* (2007) in their study on conflict management style among the Chinese, Japanese, and Koreans found that cultures play an important role in determining the conflict management style among individuals from different geographical areas. The Japanese, compared with the Chinese and Koreans, were less likely to dominate and were more likely to oblige in dealing with conflict with other parties.

According to McKenna (1995), all reactions and response to conflict stem from two general impulses as follows:

(i) The desire to satisfy personal concerns, which shows itself as assertive behavior, and

(ii) The desire to satisfy the concerns of others, which shows itself in a non-assertive behavior.

Figure 2.4 shows the conflict handling model as proposed by McKenna (1995) that illustrates the modes of conflict handling among conflicting parties. It demonstrates two behavioral dimensions and provides the basis for conflict-handling modes. McKenna (1995) then incorporated these behaviors into a fuller conflict handling model that was built around the idea that people react in one of five basic ways when faced with interpersonal conflict situations, namely competing, collaborating, compromising, avoiding or accommodating.

According to the model, the way people react and response to the occurred conflict is highly depended on the conflicting individuals' willingness to cooperate and their attitude towards the conflict either assertive or non-assertive. A more cooperative and assertive person will tend to collaborate instead of avoiding, accommodating, compromising and competing in dealing with conflict. At the other hand, an uncooperative and assertive person will tend to compete instead.

Even though handling a conflict using integrative way is beneficial for various outcomes dimensions, handling conflicts constructively is one of the greatest challenges in the modern world (Celuch, Bantham & Kasouf, 2011). Maturities grow societies, advance in scientific knowledge, and a more educated population are some of the elements needed in ensuring conflict are handled constructively. Otherwise, detrimental conflicts may continue to exist (Rognes & Schei, 2010).

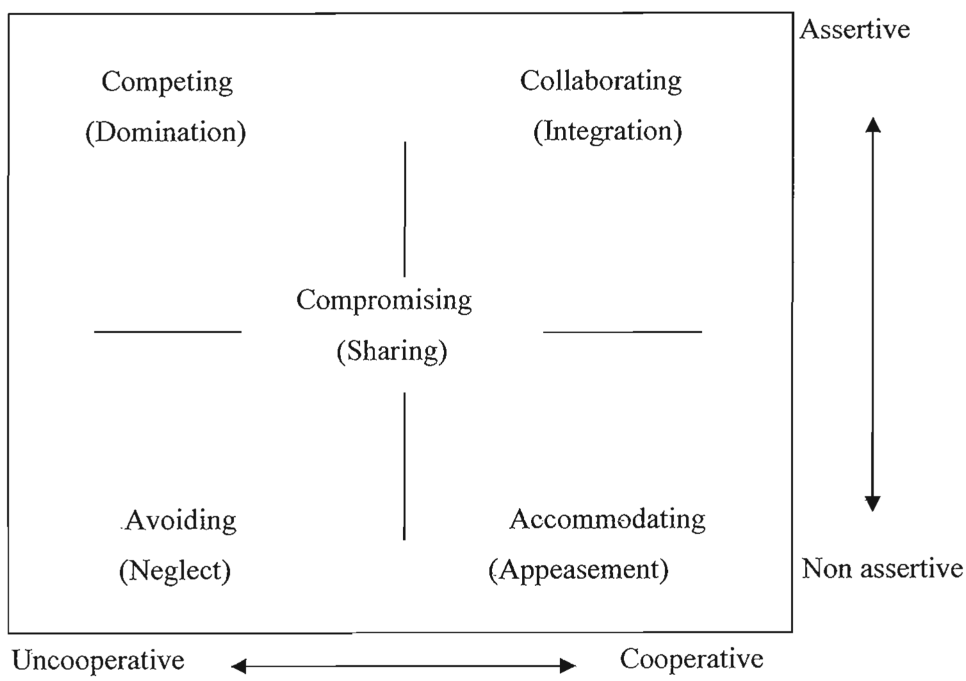


Figure 2.4
Modes of Handling Conflict
Source: Mckenna, 1995

2.4.1 The Managerial Factors (Independent Variables, IVs) vs Management Conflict

The accomplishment of a fruitful venture capital deal obliges the deal to advancement through a multi-stage process (Klonowski, 2007). This multi-stage process is not an easy task for any venture capitalists. This is because they have to face with various unique tests. Klonowski (2007) in his study on the European venture capital investment process said that venture capitalists normally have to face three major challenges in dealing with their prospects. Firstly, local venture capitalists need to teach entrepreneurs, who frequently confound funding with different sorts of financing particularly debt. At first, the primary interactions between the two sides were discovered to be troublesome, particularly to venture capitalists, where they have to at the same time go about as educators and negotiators.

Besides, local entrepreneurs are not ready to receive venture capital funding. They don't have any formal documentation depicting their businesses and, above all, regularly don't have strategies for business success or financial estimates, which are the foundation of venture capital assessment (Vinturella & Erickson, 2013; Klonowski, 2007). Thirdly, contracting and deal structuring is found to be inherently difficult. Klonowski (2007) later in his study also found that venture capitalists in the European countries agreed that the legal infrastructure in that region is not well suited for structuring venture capital deals. This frequently forces venture capitalists to structure transactions all the more imaginatively. Therefore, the deal negotiation process takes a quite long time and expedites exhaustion for both entrepreneurs and venture capitalists, bringing about numerous uncompleted transactions (Luukkonen, Deschryvere & Bertoni, 2013).

The venture capital investment process has been portrayed in different scholarly studies in the Western nations (Achleitner, Engel & Reiner, 2013; Aizenman & Kendall, 2012; Bertoni, Colombo & Grilli, 2011; Lerner & Gompers, 1999; Fried & Hisrich, 1994; Tyebjee & Bruno, 1985). The most significant contributions came from Tyebjee and Bruno (1985) and Fried and Hisrich (1994). Tyebjee and Bruno (1985) proposed a five-stage model of venture capital investing (deal origination, screening, evaluation, deal structuring, post investment activities). However, this model has been described as generally descriptive and simplistic in which it combines the heterogeneity of the investment process across different venture capital firms (Klonowski, 2007), in spite of the fact that the model portrays the whole contributing procedure and extensively highlights key investment exercises at each one stage.

Fried and Hisrich (1994) enlarged the past exploration by Tyebjee and Bruno (1985) by extensively studying the venture capitalists' investment decision making. A study by Klonowski (2007) later proposed a six-stage model (deal origination, venture capital firm's specific screen, generic screen, first-phase evaluation, second-phase evaluation, closing). It is unfortunate that such a thorough debate by Fried and Hisrich (1994) does not expand past the end phase of the venture capital investment process.

In spite of the fact that the amount of scholarly studies relating to the subject has been expanded as of late, the scope of the subject is still generally feeble and the venture capital processes within the context of developing markets are not well comprehended (Klonowski, 2007). Karsai, Wright and Filatotchev (1997) researched the Hungarian venture capital market and contrasted its development and the more improved markets of the USA and UK. Karsai *et al.* (1997) and others transcendentally concentrated on screening, valuation, and monitoring functions in Hungary. The key discoveries were that local venture capitalists kept tabs on entrepreneurial abilities, used discounted cash flow method as the essential valuation system, and were extremely animated in overseeing their investee firms.

In subsequent studies, Karsai, Wright, Dudzinski and Morovic, (1998) and Wright, Karsai, Dudzinski and Morovic (1999) took a regional comparative perspective and investigated the screening, valuation, and monitoring approaches in Hungary, Poland and Slovakia. Dimov and Milanov (2010) and Campbell II and Frye (2009) focused on structuring, monitoring, and exits. Bliss (1999) used the Fried and Hisrich framework to study the venture capital process in Poland. Bliss (1999) basically imitated the Fried and Hisrich model with two prominent contrasts in the area of deal generation and firm-specific screens.

2.4.1.1 First Stage: Deal Origination and Screening (DOS)

Access to information about high-quality investment opportunities, or the deal flow, is crucial to a venture capital firm. Venture capital firms rely on their relationships with investment bankers, brokers, consultants and lawyers to obtain leads on deals, and also count on referrals from firms they have successfully financed in the past (Petty & Gruber, 2011). Venture capital firms additionally contend specifically with different agents (investment advisory firms or brokerage houses) to spot the potential firms to be funded. A portion of the most well-known deal generating techniques incorporates self-generation where firms looking for capital will usually recognize venture capital players through expert guides or themselves straightforwardly and immediate advertising where the venture capital company's exertions are focused on recognizing deals in the sought size range, industry and phase of development (Kollmann & Kuckertz, 2010).

Deal generation in the USA and European region has found to evolve in the last decade (Cumming, Schmidt & Walz, 2010). The initial deals in the mid and late 1990s came mainly from privatization opportunities, while the later years saw venture capitalists take a more proactive role (Schertler & Tykvová, 2012; Bliss, 1999). Klonowski (2007) also noted the emergence of professional intermediaries in the venture capital industry.

Venture capitalists commonly receive many business proposals (Etzkowitz & Zhou, 2012), of which only less than 5% converted into actual investments (Bartkus, Hassan & Ngene, 2013; Coyle, 2000). In order to filter out the majority of proposals, venture capitalists also use a process known as screening. During the screening process, venture capitalists will usually reject any business proposals that are unable to meet their evaluation criteria, have been long ago unsuccessful in certain business areas, and appear to be unpromising (Klonowski, 2007; Sohaimi, 2004; Fried & Hisrich, 1994).

There are many proposals that were rejected by the venture capitalists, particularly at this stage of the process (Bartkus & Hassan, 2009). Kirkulak (2008) and Bliss (1999) confirm that screens related to industry, geography, and stages of developments are rarely used by local venture capitalists. Nonetheless, the size of the deal was found to be one of the crucial factors that will be well considered during the initial screening stage (Lingelbach, 2013). Venture capitalists also consider some government-related challenges. For instance, some European venture capital firms have intentionally decided to not participate in the privatization deals because of the existence of their government influence in the process (Klonowski, 2007).

2.4.1.2 Second Stage: Evaluating Venture Proposal (EVP)

The proposals that have satisfactorily passed the introductory screening stage are all the more intensely examined. Data incorporated in the furnished reports is affirmed and financial key forecasts are examined (Annamalai & Deshmukh, 2011). The company's key employees, customers, suppliers, and creditors are also consulted. Among the key evaluation criteria used are product, management, market, and returns (Yang, 2012; Sohaimi, 2004; Tyebjee & Bruno, 1985; Fried & Hisrich, 1994). Though the general objective of this due diligence process is to gain a thorough understanding of all business aspects, the focus of investigation may vary from deal to deal (Klonowski, 2007).

The venture capitalist's professional experience is crucial to the general effectiveness of the evaluation process (Lam, 2010; Klonowski, 2007). Studies by Klonowski (2005), Wright *et al.* (1999), Bliss (1999) and Karsai *et al.* (1998) affirm a few contrasts in the way venture capitalists assess deals over the European locale. For example, Karsai *et al.* (1998) proposed that investors in Hungary and Slovakia concentrate on the assessment of market opportunities, while entrepreneurial aptitudes and a good and excellent track record are the key concern for Polish venture capitalists.

Studies by Klonowski (2005) and Bliss (1999) replicated these results in studies that were conducted based on single-country basis. Moreover, Klonowski (2005) and Bliss (1999) affirmed the significance of evaluating external factors, especially the matters related to country's legal and fiscal infrastructure. Also, the overall studies directed in the European mainland confirm the vitality of a venture capital return potential.

2.4.1.3 Third Stage: Contracting and Deal Structuring (CDS)

Venture capitalists will proceed to negotiate the deal once the conducted due diligence does not identify any major areas of concern (Petty & Gruber, 2011; Klonowski, 2007; Fried & Hisrich, 1994). The scholarly writing identifying with venture capital contracting is noteworthy. Tian (2011), Campbell II and Frye (2009), Kirilenko (2001), Black and Gilson (1998) and Sahlman (1990) concentrate on the level of control practiced by venture capitalists and affirm that venture capitalists revel a substantial level of control. Kaplan and Stromberg (2003) give a complete depiction of the essential rights found in venture capital contracts. Winton and Yerramilli (2008) and Chan, Siegel and Thakor (1990) depicted the striking characteristics of venture capital contracting, incorporating the failure of entrepreneurs to walk away from the business.

Research done by Klonowski (2006) and Farag, Hommel, Witt and Wright (2005) reported the complexities of deal structuring in venture capital investment in the European continent by inspecting information from distinctive nations. Klonowski (2006) found that local venture capitalists keep on depending on offshore legal structures in deal structuring to deal with the lacks of the local lawful framework. Farag *et al.* (2005) affirmed the use of straight common equity as the most critical instrument in financial contracting. Both Klonowski (2006) and Farag *et al.* (2005) affirmed the significance of exit provision in venture financial contracting.

2.4.1.4 Fourth Stage: Monitoring and Post Investment Activities (MPI)

Venture capitalists' animated association in their investee firms is identified with information asymmetry and an expanded time of illiquidity. Any information asymmetry venture capitalists face can cause serious agency risks (Mavlanova, Fich & Koufaris, 2012). In response, an expanded time of illiquidity may lead towards the uncertain exit situation and low investment returns. For the purpose of reflecting the current market conditions and changes in business opportunity, business plans, operational goals, and shareholder agreements need to be periodically and continuously assessed and reviewed, once the initial deal is sealed (Autore & Kovacs, 2010). While the involvement of venture capitalists in an investee firm differs from arrangement to arrangement, new ventures require more aid than developed businesses (Tykvová & Schertler, 2011; Barry, 1994).

2.4.1.5 Fifth Stage: Acquiring Liquidity (AL)

Performing the divestment or investment harvesting is the most crucial aspect that becomes the major concern by most venture capitalists during the post investment stage. Divestment is determined by a venture capitalist's requirement to create earnings for their fund providers and associates (Dai, Jo & Kassicieh, 2012). Divestment can normally be achieved via two common methods: an initial public offering (IPO), or a trade sale to strategic investors. Regardless, there are different consequences for both venture capitalists and entrepreneurs for each exit route selected (Giot & Schwienbacher; 2007).

Traditionally, many investee firms prefer a public offering. It is because the exit method preserves the independence of both the firm and the entrepreneurs besides continuously providing the firm with access to capital. From the venture capitalists side, a public offering seldom ends their business relationship with the investee firm. This is because there is a lock up period after the IPO. During the lock up period, the underwriters can avoid venture capitalists from selling of all shares at the time of an IPO. At the other hand, choosing private sales as the exit route will definitely end the relationship and venture capitalist's involvement with the investee firm. It is because all the venture capitalists' interests will be disposed once their investment interests in the investee firms are sold to other parties (Neus & Walz, 2005).

The selection of venture exit routes and its consequences are not well portrayed in the scholarly writings due to the insufficient data (Paeglis & Veeren, 2013). Although Bliss (1999) cited that there were many investors facing difficulties to divest their venture investment via trade sales during the mid-1990s, European Venture Capital Association (EVCA) Yearbook (2002) affirms a substantial increase in venture divestment within the European countries during early 2000s. In a study done by Farag *et al.* (2005), it is affirmed that trade sale is the most practical exit route within the context of European countries.

2.4.1.6 Risk Management (RM)

Risk management refers to the activities or methods utilized by venture capitalists to drive away any unnecessary risks in ensuring their investments in their investees are well protected (Obrimah & Prakash, 2010). Few studies have focused on post-investment activities, especially in the European region. The study by Farag *et al.* (2005) and Wright *et al.* (1999) provided an assessment of local venture capitalists' value-added activities and monitoring techniques in the European countries.

Local venture capitalists are expected to provide operational assistance, especially in the area of marketing (Lim, Busenitz & Chidambaram, 2013; Yitshaki, 2008; Farag *et al.,* 2005; Wright *et al.*, 1999). While some differences were noted in the key means of monitoring investee firms across the region, most venture capitalists were found to require active interaction at the board level (through written reports and verbal communication) to identify any potential problems and devise appropriate solutions (Gimmon *et al.*, 2011; Farag *et al.*, 2005).

2.5 NOMINEE DIRECTOR/NON-EXECUTIVE DIRECTOR (THE MODERATOR)

This term refers to individuals usually from the venture capital companies' top management personnel, which were appointed to become a nominee director in the firms (investee firms) funded by the venture capital investment. The nominee director major roles comprise of monitoring and to supervise the investee firms operation from various operational aspects (financial, marketing, human resource, strategic management, risk management) in ensuring that the funded firms are complying with the venture capital contractual agreement. The nominee directors are the venture capitalists representative in the investee firms' board of directors.

2.5.1 The Placement of a Nominee Director(s)/Non-Executive Director(s) in the Investee Firms' Board of Directors

Over the past years, suggestions on the method to improve effectiveness of the board, including mitigating the conflict between the principal companies and their investee firms and corporate governance focused on the function of the nominee directors or non-executive directors, which are seen as very crucial tool for ensuring corporate accountability (Boxer, Berry & Perren, 2012; Aggarwal, 2010; Bose, 2009). Subsequent to the global scandals, policy makers responded badly to managers' embezzlement and frauds by combating the dispute among all stakeholders in the company through the enlargement of board autonomy from those influential people within and outside the company (Hearn, 2013; Arosa *et al.*, 2010).

That's been the case, codes and guidelines relating to non-executive directors were strengthened. The Sarbanes–Oxley Act enacted by the United States parliament in 2002, and the New York Stock Exchange (NYSE) listing guidelines and regulations stipulates that the board of directors of publicly listed firms should comprise a greater number or percentage of independent directors. The Act also required that only independent directors should constitute the audit committee, and at least one of them must have knowledge and experience in accounting and finance (Aggarwal, 2010).

The guidelines for composition of board in publicly listed firms in United Kingdom were strength in the year 2003. The updated code of corporate governance requires that at least half of the board members should be independent nominee directors, separation of the board chairman and Chief Executive Officer, nomination committee should be constituted with majority of independent directors, and that remuneration and audit committee should be independent. The passing into law of Sarbanes Oxley law in the United States and the United kingdom code of corporate governance empowered other countries to strengthen their code on board composition and independence (Jiang, Ferris & Coffman, 2009).

The term independent or nominee director and non-executive directors simply mean those directors who are appointed to oversee the activities of the management on behalf of the shareholders. They do not have any financial interest in the company, are not an employee of the company. And they do not participate in the daily activities of the company (Fahlenbrach, Low & Stulz, 2010). The term nominee director, extend to mean an individual without a financial connection/link with the organization, its promoters, top managements' or associate organizations, have no relationship with the promoters or top management. The person must have not been an executive in the organization in the immediate last three financial years, and not a partner or executive of the auditors/lawyers/consultants of the company, is not a supplier, service provider or customer of the company, and does not hold two 2% or more of the shares of the company (Aggarwal, 2010).

Aggarwal (2010) further defined a nominee director/non-executive director as someone whose position doubled as agents and trustees. Therefore, the legal power to operate or do something for the benefits of the company or their nominator is with them. These directors would be whistle-blowers ensuring the shareholders' interests in the companies they were assigned are well protected. Their function is to give an unbiased statement on certain issues such as corporate strategy and performance.

However, there are still much concern about how to determine those suitably qualified people willing to engaged on certain function (Nguyen & Nielsen, 2010).

According to Masulis, Wang and Xie (2012), majority of the directors from outside companies also doubled as managers in other companies whereby they involved in taking vital decisions for the companies. These outside directors are not full time directors and they spent part of their available time annually as the independent directors in the companies they were assigned. Most recent studies on corporate governance often depict outside directors as nominee directors/non-executive directors, a terms considered to be too generalist compared to the meaning by Cadbury Report in the U.K. that equally emphasis the significant of autonomy and the nominees' director capability (Sharma, 2011). In this context, nominee directors are assumed to act or stand for shareholders with a view to settle the agency problems (Nguyen & Nielsen, 2010).

The nominee directors are perceived as experienced and influential part-timers who are independent and neutral in nature. Therefore, they are trusted individuals, appointed to ensure that standards and regulations in the companies they were assigned are well maintained (Fahlenbrach *et al.*, 2010). The nominee directors are expected to police the executive, to be accountable for the ethical management of the business, remuneration policy, board composition and the sound management of the business (Masulis *et al.*, 2012).

The Malaysian Companies Act 1965 did not define the term nominee directors, section 132 (1E) makes reference to a director appointed by virtue of his position as a staff of an organization, or nominated to represent the shareholders, employer or debt security holder. The act also tacitly recognizes the existence of nominee directors in section 176 (10A) (d) in relation to the appointment of directors by majority creditors where the firm is in the quest to make an arrangement or compromise with its creditors.

From the above, the following interpretations may be made:

(i) It is the responsibility of shareholders or class of shareholders, staff, and debt holders to appoint a nominee director.

(ii) The non-dependent in the mode through which they are being nominated, the nominee directors commonly act in line with some understanding, arrangement or status which leads to a fiduciary duty to the nominator.

(iii) The nominee director, thus has extraneous loyalty and may therefore be indebted to act in the interests of the nominator or at the very least to protect the interests of the nominator.

(iv) The agreement for the nominee directors to carry out their duty in the best interests of the nominator may be written or unwritten.

The debate on whether a nominee director will protect the interest of their nominator in the presence of interest conflict between the organization/firm and the nominator has not been concluded (Nguyen & Nielsen, 2010). Theoretically, it has been recommended that the nominee director's ultimate allegiance is to the nominator (Aggarwal, 2010). On the other hand, solving it will not be easy because there are unbending approaches in either direction. Such rigidity and irrationality will only create evasion and creative compliance (Salim & Yong, 2008).

The concept that nominee director has the prospective to make a strategic contribution to the company was backed by the study of Hamill, McGregor and Rasaratnam (2006). The study indicated that nominee directors are mostly appointed in companies that is not performing very well, which imply that they (nominee directors) will bring in their expertise to turn around the company performance. But on the other hand, Duchin *et al.* (2010) has a contradictory view on the benefit of appointing a nominee director. The study disagreed with the nominee directors' ability to contribute to shareholders' wealth due to lack of time, expertise and incentives. In considering the relationship between boards and firm performance, studies indicated that a positive relationship exists between the boards' characteristics and the firms' performance (Arosa *et al.*, 2010; O'Connell & Cramer, 2010).

Finance theory stressed how separating ownership and control in companies leads to agency problems because the shareholder (principal) faced costs and other problems in monitoring the manager (agent) (Campbell II & Frye, 2009). A nominee director represents the shareholder in the boardroom and has the responsibility of determining the pay for the executive and incentives. A diligent nominee director is expected to reduce the agency problems by the alignment of the managers' interest with that of the shareholders (Jiang *et al.*, 2009). The effect is that, nominee directors can prevent the management from pursuing of a quiet life, wasteful spending on less important matters or following personal goals through mergers or the non-payment of dividend to the shareholders (Nguyen & Nielsen, 2010).

Regardless of the stress on their governance function, an acceptable explanation for nominee directors is still lacking (Goo & Hong, 2011). In the narrowest terms, nominee directors can be defined as directors who were appointed to represent their nominator in other companies' board in ensuring their nominator shareholders' interest are well protected (Aggarwal, 2010; Fahlenbrach *et al.*, 2010). Besides, there is no experience of any kind of business or any form of association with the companies' top managers that can influence their accountability towards the companies they were assigned (Jiang *et al.*, 2009). The most popular technique describes nominee directors as any person that do not have any business or family association that might cause dispute with the company (Siagian & Tresnaningsih, 2011). Building on this technique, nominee directors are perceived to be free from any kind of association, whether inside or outside relationship with the company. Examples include staff, employees, suppliers and banks (Chen, Chen & Wu, 2011).

Nominee directors are supposed to be neutral and independent. Directors' autonomy is perceived to be first as a condition vital for one board task which is the management impartialities (Le, Kroll & Walters, 2013), although, autonomy equally has additional explanation, which is important and vital for the accountability process. Autonomy suggests capacity that makes the nominee directors to view issues in a different manner (Hou & Cheng, 2012). Nominee directors are expected to inject their previous experience to the board, these experiences they acquired give them the opportunity to think differently from the executives on certain issue. For example, issues concerning strategic decisions (Hou & Cheng, 2012). The integration of abilities, experiences and views among the different board members encourage creativity and innovation that brings solutions to problems through which quality decisions can be accomplished (Arosa *et al.*, 2010; O'Connell & Cramer, 2010).

2.5.2 The Knowledge and Skills of Nominee Directors

One of the determinants of the effectiveness of the board is the mixture of experience and competencies from members of the board (Al-Najjar & Hussainey, 2009). Management research relating to the board demonstrates that directors operate or act double roles the purpose of effectiveness (Aggarwal, 2010; Campbell II & Frye, 2009; Jiang *et al.*, 2009).

The role, functional knowledge and skills apart from the conventional management areas like marketing and accounts also cover other areas such as environmental management (Duchin *et al.,* 2010). The knowledge and abilities of the nominee directors are indispensable for the effectiveness of the company (Nguyen & Nielsen, 2010). Nominee directors are seen as trustworthy people with unique characteristics among other directors (Sharma, 2011). Furthermore, firm-specific knowledge and abilities are essential for the nominee directors. Lack of adequate familiarity about the company and its operations would very hard to handle certain issues raised at the board meeting.

Nominee directors should play active roles and scrutinize in detail the information given by the management with proper ideas or attention to further explore information relating to the organization and the sector (Masulis *et al.*, 2012). According to Song, Ji, Wen and Lee (2013), a survey among CEOs regarding the nominee directors' quality of the firm specific knowledge revealed that most of them concur that members of the board require comprehensive knowledge on the key factors influencing the company strategic success while also making complaints about the insufficient time spent by the nominee directors to acquire knowledge (Arosa *et al.,* 2010). In the final analysis, it should be noted that competencies as well as specific information are vital aspects of nominee director effectiveness determinant.

Nominee directors should be concerned about doing their own jobs in order to become effective (Bose, 2009). For instance, they should put more strength and time to gain sufficient knowledge of the company through involving themselves in the company challenges besides becoming a good gatekeeper (Pombo & Gutiérrez, 2011). Though, some researches have revealed that nominee directors have failed to effectively do board jobs (Le *et al.*, 2013; Chen *et al.*, 2011; O'Connell & Cramer, 2010), as a result of their busyness and limited time to do their jobs (Kim &Lim, 2010).

2.5.3 Nominee Director Roles and Responsibilities

The role of the nominee director is often termed as that of a long-term, agreement-based decision maker (Song *et al.*, 2013; Long *et al.*, 2005) and as overseer of the governance process (Nguyen & Nielsen, 2010). The nominee director's core function is supervision and monitoring of the management activities in addition to the carrying out advisory tasks (Fahlenbrach *et al.,* 2010). Previous study, for instance Goo and Hong (2011), has noted two major roles which nominee directors play in the board. The nominee directors play a role of performance and compliance. By performance roles, the nominee director is expected to contribute to the overall performance of the organization/firm which includes bringing his/her wealth of knowledge and experience, collecting and sharing of information, creating links to the outsiders and representing the firm. The compliance role which the nominee directors play refers to ensuring that the firm comply with the board resolution (policies, processes and plans) which includes judging, inquiring and supervision of the executive management in addition to being a watchdog and safety valve roles (Goo & Hong, 2011).

According to Duchin *et al.* (2010), the nominee directors in performing of their duty do act as an advisor to the executives when the need arises. Kim and Lim (2010) also noted that the presence of independent nominee director does affect companies positively. Chen *et al.*, (2011) identified three main roles which directors play to include control, service and resource dependency. The notion here is that the independent directors play the role of monitoring and reporting, in addition to individual and collective enforcement of policies.

Song *et al.* (2013) noted that independent director plays two major roles which are giving assistance and supports to the management and the monitoring of the decision made by the executives. The study also noted that this role involves reviewing the performance of management to ensure that the executives' activities is aligned with the shareholders' interest, and as well in conformance with legal obligations, regulatory requirements and ethical imperatives related to the operation of a listed firm.

Some effort has been made to codify the fiduciary duties of nominee directors. For instance, the New Zealand Companies Act 1993 had attempted to codify the realistic approach by allowing for an adjusted fiduciary duty where this is allowed by the constitution of the organization (Salim &Yong, 2008). Malaysian company Act 1965 recently has a new provision which requires a nominee director to act in the best interest of the company in the event of conflict between the interests of the company and his nominator. The breach of this section is punishable by law, both as civil and criminal. This was in line with the recommendation of the Malaysian High Level Finance Committee on Corporate Governance and the Malaysian Corporate Law Reform Committee (CLRC, 2006). Both the Finance Committee and the CLRC recommend a stringent approach to be introduced into the Malaysian Companies Act 1965 (Salim & Yong, 2008).

There is a trite law which said that nominee directors owe fiduciary duties to the company (Salim & Yong, 2008). Salim and Yong (2008) in their study on the nominee directorship have concluded that nominee directors must act bona fide in the best interests of the company based on the Lord Greene MR statement below:

> *"[The directors] must exercise their discretion bona fide in what they consider, not what a court may consider, to be in the interests of the company, and not for any collateral purpose. . . It is beyond question that that is a fiduciary power, and the*

directors must exercise it bona fide in what they consider to be the interests of the company."

Generally, the directors' principal duty is to protect the interest of the company which traditionally refers to shareholders' interests (Bose, 2009). In an event of a takeover, the interests of the shareholders may mean the interests of current shareholders. From the United Kingdom perspectives, much emphasis is placed on the company's long term future instead of the shareholders as the ultimate focus of directors (Boxer *et al.*, 2012). This is in line with the enlightened shareholder value approach which embraces the stakeholder approach without sacrificing the interests of the shareholders as paramount.

This is now reflected by section 172 of the UK Companies Act 2006, which provides as follows:

Section 172: Duty to promote the success of the company.

(1) A director of an organization must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to:

- the possible consequences of any decision in the long term,
- the employees benefits in the company,
- the need to foster the company's business relationships with suppliers, customers and others,

- the impact of the company's operations on the community and the environment,
- the desirability of the company maintaining a reputation for high standards of business conduct, and
- the need to act fairly as between members of the company.

In the Malaysian context, even though the Companies Act 1965 states the responsibilities of directors to work for the benefits of the company, the nominee director expression is yet to be defined. Thus, the explanation is left to the courts to decide (Salim & Yong, 2008).

Outside directors have been involved in cases whereby they arranged to remove and replace executive in important positions in a condition whereby corporate performance is standardized (Min, 2013). This checkmating situation provides an opportunity to avoid management entrenchment. The outside directors play a major role in checking dubious deals by individuals and other hygiene issues, helping to fight some strategies such as growth and diversification strategies that benefit managers, but not deemed best by the shareholders and the economy in general (Min, 2013).

Long *et al.* (2005) studied the differences among the nominee director roles in listed and unlisted companies in the UK boards. The study investigated both male and female UK nominee directors. The gender representation was 84% for male and 16% for female which represents an average age of 58.1years. 28% of the respondents have an honorary title, given an average of 3.0 listed companies for the respondents and 3.4 unlisted companies. In all, a total of 74 listed businesses and 86 unlisted businesses were represented. 44% of the participants possess family business, 28% participants have venture capital business experience, and 72% of all the participants claimed to be professional nominee directors. For the nominee directors in the UK listed companies, the study found that they were highly involved in the following roles:

(i) executive monitoring,

(ii) remuneration, appointment and removal of staff and executive, and

(iii) succession planning.

On the other hand, the nominee directors were found to have less involvement in the UK listed companies in the following roles:

(i) creating business strategy,

(ii) financial scrutinizing,

(iii) shareholder communication, and

(iv) overall contribution.

For the nominee directors in the UK unlisted companies, the study found that they were highly involved in the following roles:

(i) creating business strategy,

(ii) financial monitoring,

(iii) shareholder communication, and

(iv) overall contribution.

The study found that the UK nominee directors in unlisted companies were less involved in the following roles:

(i) executive scrutinizing,

(ii) remuneration, appointment and removal, and

(iii) succession planning.

The Long *et al.* (2005) study findings regarding the roles of UK nominee director roles in listed and unlisted companies are shown in Figure 2.5. According to Song *et al.* (2013), nominee directors basically accomplish two key functions, namely strategic advisor and corporate watchdog. Song *et al.* (2013) also said, nominee directors should be unbiased and this would help them accomplish effective supervising functions. However, it could be doubtful if nominee directors effectively accomplished their watchdog function. This is due to the reason that, nominee directorship is not a full time responsibility because so many nominee directors are equally a nominee director somewhere else (Hou & Cheng, 2012; Chen *et al.*, 2011). Accordingly, the board of directors also meets for a few times within the period like the supervisory board. This suggests that the amount of time spent by the nominee director is quite limited in the company (Nguyen & Nielsen, 2010).

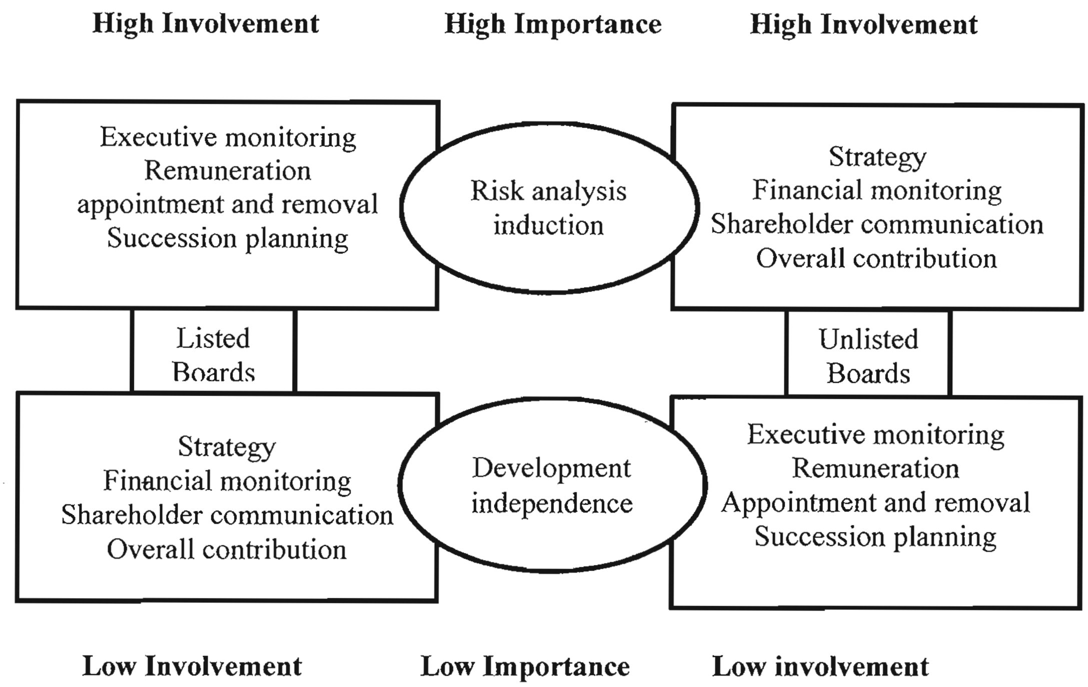


Figure 2.5
The Roles of UK Nominee Directors in the UK Listed and Unlisted Companies
Source: Long *et al.*, 2005

Because less time is spent on board activities, there is a tendency that nominee directors may not be able to manage his/her affairs in depth (Autore & Kovacs, 2010). Coupled with the problem of part-time is the irregularity of information between the executive and nominee board members (Batabyal, 2012; Aggarwal, 2010). The situation above creates some sort of difficulties for outside nominee directors to have adequate knowledge about the company and its activities (Yung & Zender, 2010). Finally, nominee directors therefore depend on the information from the Chief Executive Officer (CEO) to do their jobs.

To summarize this point, it is presumed that nominee directors, while executing their directorship responsibilities should always try to protect the company interest, that is, always at the company perspective. Besides, considering every situation within the company is also required by the nominee directors. Such situation may involve various groups within the company. However, it must be in line with the company act and benefits (Boxer *et al.*, 2012).

2.5.4 Nominee Directors in Venture Capital Financing

While other related studies attempted to address various mechanisms utilized by venture capitalists to reduce management conflict in venture cooperation (Dahiya & Ray, 2012; Leisen, 2012; Tian, 2011; Obrimah & Prakash, 2010; Tan, Zhang & Xia, 2008), the study on the effect of nominee director placement on the venture relationship between venture capitalists and their investee firms seems to be scarce and limited. According to venture capital literature, most venture capitalists will tend to nominate at least one nominee director in their investees' board once venture capital funds have been released (Leece, Berry & Miao, 2012; Zattoni & Cuomo, 2010; Campbell II & Frye, 2009). The placement of this nominee director is a directing tool utilized by most venture capitalists for monitoring, controlling and supervising purposes besides protecting the shareholders' interests in their investee firms (Masulis *et al.,* 2012; Goo & Hong, 2011).

Out of the three purposes mentioned above, control is seen as the major objective that justifies the placement of a nominee director in the investees' board (Fahlenbrach *et al.*, 2010). Control is the process through which venture capitalists guarantees a venture business is being run and controlled according to the venture capitalists' interest (Sharma, 2011). There are several control tools in venture cooperation: Some among others are board meetings and structure of decision makings (Annamalai & Deshmukh, 2011; Chowdhury, 2009). Key personnel refer to nominee director or non-executive director which normally will be placed in venture cooperation in high ranking positions in those important areas of the ventures (Duchin *et al.,* 2010). The power to appoint nominee director gives the venture capitalists, some sort of power at the top level, which gives room for an effective interaction between the venture business and venture capitalists (Chen *et al.*, 2011).

The appointment of a nominee director is critical to the venture capitalists because the nominee director has the right to execute policies and rules formulated by the Board of Directors and make daily changes, including those addressing personnel matters (Kim & Lim, 2010). The general managers' independent differs, however, increases during short meeting with the board (Lin, 2007). The existence of the nominee director's indicates a situation to checkmate the activities of the executive directors in order to see whether the executive directors executing the company's policies in line with the interest of the shareholders (Song *et al.*, 2013).

According to Aggarwal (2010), a nominee director is a position where its job scopes and responsibilities comprise of the mix of agents and trustees. Within the venture capital financing context, nominee director acts as an agent on behalf of their venture capitalists principal and their main duty is to monitor their principal's investees in ensuring that they are complying with their principal's requirements. Besides, someone who has been appointed as a nominee director should properly represent the interests of the venture capitalists they represent. The nominee directors' function is considered as a long-term, consensus-based decision maker (Tang, Du & Hou, 2013), and as a custodian of the governance process (Siagian & Tresnaningsih, 2011).

As a nominee director is appointed in helping their principal (venture capitalists) to oversee their investees, they are expected to be unbiased in supervising the management of the company and at the same time should be given free access to management information. Therefore, they should be self-governing. Not only that, but also constitute a reasonable size of people with the ability to convince the investees board (Chen *et al.*, 2011).

2.5.5 Nominee Director Roles in Venture Capital Financing

From the discussions in the previous section, it can be inferred that nominee directors in venture capital financing play four major roles which can be categorized as follows:

(i) Monitoring and Reporting Role

Nominee directors appointed in the investees' board are expected to monitor their principal's investees from two main dimensions, namely Operation and Behavior in ensuring that the investee firms are complying with the venture capitalists' requirements. For monitoring role under Operation dimension, nominee directors are expected to monitor the investee firms operating performance and to ensure that the investee firms' performance will always be at the optimum level. Besides, nominee directors are expected to report to their venture capitalists principal any problems encountered by the investee firms in their operational and technical aspect. Therefore, necessary aids and assistance will be provided in helping the investees back on the right track (Arosa *et al.*, 2010; Duchin *et al.*, 2010; Long *et al.*, 2005).

For monitoring role under Behavior dimension, nominee directors are expected to monitor the investee firms' management team behavior in ensuring that there is no conflict of interest between them and their venture capitalists (Bose, 2009; Treadwell, 2006). For instance, there are possibilities for agency problem to exist in any venture cooperation. The agency problem exists once the investee firms' management has started to drift from achieving their original venture goals in pursuing their own private goals. Nominee director should assist in reducing the high cost of agency costs via an effective manager and shareholders interest support. In this case, the nominee directors are required to checkmate the executive for the purpose of accountability and also ensuring proper business management ethics among others (Fahlenbrach *et al.*, 2010; Treadwell, 2006).

The nominee directors are experienced, independent and neutral in nature. Hence, they are trusted individuals, expected to ensure that standards and regulations in the companies they were assigned are well maintained.

(ii) Supervisory and Strategic Role

Besides monitoring and reporting role, nominee directors placed in the investee firms' boards are also expected to play supervisory role. Most outside directors are perceived to occupy managerial positions or key decision agents in other organizations (Yuan, 2009; McCabe & Nowak, 2008). They also should play active roles in analyzing in detail management information so as to be able to discover other relevant information about the company as well as the industry (Le *et al.*, 2013). Therefore, this role requires any nominee directors placed on the investees' boards to be objective in their thinking about the investees' corporate strategies, performance, financial management, resources, appointments and ethics (Froud, Leaver, Tampubolon & Williams, 2008). Nominee directorships should also offer positive advice to the executives, particularly when their views are sought by the executive (O'Connell & Cramer, 2010).

Nominee directors are also expected to share with the investees' board their past daily experience as they are believed to have many different views that would assist the executives to make strategic decisions (Yuan, 2009). In this case, there is a possibility that the integration of variety of nominee directors' skills with different views of the board members would encourage creativity and innovation which could be used to solve certain problems and make sound and strategic decisions (Le *et al.*, 2013). Besides, nominee directors also should play a major role in the company performance, and should contribute in some other areas like external information, technical know-how and expertise including networking (Duchin *et al.*, 2010).

(iii) Moderator and Problem Solving Role

Conflict seems to be inevitable in many venture cooperation due to many factors and determinants. Conflict in venture capital financing exists when both venture capitalists and their investees having different opinions and stands pertaining certain matter related to their venture cooperation (Gimmon *et al.*, 2011; Avgar, 2010; Speakman & Ryals, 2010; Yitshaki, 2008; Sohaimi, 2004). In most of the cases, conflict in venture capital financing will only harm venture cooperation besides preventing both venture capitalists and their investees from developing a cordial relationship in creating successful venture businesses (Gimmon *et al.*, 2011). Therefore, any nominee director placed in their principal venture capitalists investees' boards should be able to play their role as a moderator and also a problem solver.

The problem solving roles requires nominee directors to work closely with their venture capitalists principal and their investees in solving any conflict and problems occurred in their venture cooperation. This is the time where the nominee directors placed are expected to be able to become independent, unbiased and able to use their expertise and negotiation skills to find the best solutions for the conflict between their venture capitalists principal and their investees (Chen *et al.,* 2011; Nguyen & Nielsen, 2010; Hamill *et al.*, 2006). Furthermore, they are also expected to put more time and effort in order to be well-informed and experienced about the investee firms, thus, making them to be concerned with the investee firms' problems prior selecting the best options to solve the problems (Pombo & Gutiérrez, 2011).

The moderator roles played by the nominee directors are expected to be able to moderate the relationship between the venture capitalists and their investees. Using their expertise, expert knowledge and independent judgment, nominee directors placed are expected to be able to restore good venture relationship between their venture capitalists principal and their investees besides reducing the possibilities for any conflict to persist.

As noted in the literature that nominee directors need to be committed to the nominators or their venture capitalists principal (Duchin *et al.,* 2010; Nguyen & Nielsen, 2010; Salim & Yong, 2008). Bearing this in mind, nominee directors are expected to stand in for the shareholders in every decision they made so as to solve certain problem such as agency problems (Froud, Leaver, Tampubolon, & Williams, 2008). However, it is believed that they should be given full authority to become solely independent and use their expertise, experience and expert judgment in selecting the best solution to cure the conflict between their venture capitalists principal and their investees (Chen *et al.*, 2011; Froud *et al.*, 2008; Treadwell, 2006). The independent status will help nominee directors to yield better decision which can benefit both venture capitalists and their investees since biased decisions will merely create evasion and creative compliance.

2.6 EMPIRICAL LITERATURE ON VENTURE CAPITAL

Business idea generation process plays an important role in determining a good and profitable business that can be ventured into by the entrepreneurs and corporations. Entrepreneurs have long had ideas that required substantial capital to implement, but lacked the funds to finance these projects themselves (Andrieu & Groh, 2012; Behrens, Patzelt, Schweizer & Bürger, 2012; Minai & Lucky, 2012). While many entrepreneurs have used bank loans or other sources of debt financing to finance their businesses (Vinturella & Erickson, 2013; Andrieu & Groh, 2012; Chua, Chrisman, Kellermanns & Wu, 2011), start-up and young companies that lacked substantial tangible assets were inundated with several years of negative earnings, and have had uncertain prospects and were often been forced to struggle to find alternative sources of business financing (Chua *et al.*, 2011). One other option for this problem is to use venture capital to fund these high risks and potentially high rewarding business ideas (Fairchild, 2011).

Venture capital is an investment, usually in small private companies that need to finance their startup, expansion, survival or to procure a change of ownership (Li & Mahoney, 2011; Tian, 2011). The main return on venture capital investments is usually a capital gain rather than dividend yield (Alperovych & Hübner, 2011; Cochrane, 2005). According to Coyle (2000), venture capital is often required by a business at a critical point in its development when it is planning to expand its product range or start selling into new markets.

Venture capital as investment by specialized venture capital organizations (which we call 'venture capital funds') in high-growth, high-risk, often high-technology firms that need capital to finance product development or growth and must, by the nature of their business, obtain this capital largely in the form of equity rather than debt (Vinturella & Erickson, 2013).

Benson and Ziedonis (2010) define venture capital as an investment by professional investors of long-term, risky equity finance where the primary reward is an eventual capital gain, rather than interest income or dividend yield. This capital gain is realized when the venture capitalist or investing partners sell or otherwise liquidate their equity stake in the venture. By investing in a particular entrepreneurial firm, the venture capitalist assumes a high level of risk. Bertoni *et al.*, (2011) found that 34.5 % of venture capital investment results in a loss. The investors attempt to minimize these risks by controlling the stages and the level of capital infusion (Tian, 2011), using built-in incentives to reward entrepreneurs' desirable behavior (Tang, 2012) and often taking a very active role in managing the firm (Winton & Yerramilli, 2008).

Venture capital is one of the alternative business financing methods for privately held companies, generally in the form of equity and/or long-term convertible debt (Vinturella & Erickson, 2013; Winton & Yerramilli, 2008). It becomes available when funding from banks or similar financial institutions and the public debt or equity markets is either inappropriate or unavailable (Andrieu & Groh, 2012).

Venture capital financing requires both entrepreneurs and venture capitalists to join together in a legal contract that call for the commitment from each party to contribute their available resources for the sake of the venture success. As for the venture capitalists, they are liable to provide the fund, expertise and knowledge which are really needed by the entrepreneurs to materialize their business ideas or to expand their existing business (Flor & Grell, 2013; Bottazzi, Rin & Hellmann, 2008; Sohaimi, 2004). On the other side, the entrepreneurs are liable to run their funded firm using their technology and expertise and ensure that its objectives are always in line with the venture capitalists' interest (Guo & Jiang, 2013; Sohaimi, 2004).

Based on the various definitions given to venture capital, Naqi and Hettihewa (2007) defined and concluded venture capital as:

- invested through firms which are, generally, private partnerships or closely-held corporations,
- raised from private and public pension funds, endowment funds, foundations, corporations, wealthy individuals, foreign investors, and the venture capitalists themselves,
- directed toward innovative, rapidly growing, high-technology companies,
- in the shape of equity, mostly preferred or convertible stock, in unlisted businesses,
- accompanied by assistance from primary investors in the development of new products or services and value-added participation,
- high risk with the expectation of higher rewards, and
- long-term, usually 5–7 years.

From the above definitions, venture capital in this study can be defined as funds provided to companies by venture capital organizations or wealthy individuals. It is provided by an external investor or group of investors rather than by the owners or management of the business. The amount of money invested as venture capital is usually much greater than the investment of the entrepreneurs themselves and usually the financing package will be structured so that the entrepreneurs of the business will have a sizeable equity stake. Because venture capital is a high risk capital, the investors usually will seek to protect its investment by maintaining a close association with the company. This often can be done through appointing a nominee to the board of directors to monitor the everyday business activities.

2.6.1 The Role of Venture Capital in the Economy

According to Strömsten and Waluszewski (2012), venture capital comprises three types of investing, namely seed, start-up and expansion investment. These types represent the three stages of investing, which are defined with reference to the stage of development of the company receiving the investment, namely:

(i) Seed stage
(ii) Start-up stage
(iii) Expansion stage

(i) Seed Stage Investment

Seed capital is the very first type of financing a newly formed company might want to secure. Seed capital funds are typically used to fund initial product R&D and to assess the commercial potential of ideas.

(ii) Start-up Stage Investment

Start-up investments, on the other hand are targeted at companies that have moved past the idea stage and are gearing up to produce, market and sell their products. Companies at this stage still use more cash than they generate.

Investments in either seed or start-up stage are also referred to simply as early stage investments (Andrieu & Groh, 2012).

(iii) Expansion Stage Investment

After a company has passed through the early stage, it becomes a potential candidate for expansion stage investing. In the expansion stage, a company that has already established its product in the market place often needs additional capital to fund the growth of its manufacturing and distribution capacity as well as to fund further R&D (Nahata, 2008). The other category of investments included in private equity in addition to venture capital is buyouts. Buyouts are usually applied to more mature companies. In a leveraged buyout, debt is used as a tool to acquire a company and reduce its equity base. Management buyouts are leveraged buyouts where current management takes control of its company (Ughetto, 2010).

Venture capital firms serve as financial intermediaries in a market where lenders and borrowers find it costly to get together. Most entrepreneurs will require a substantial amount of capital to start or to expand their current business. But, since banks and other financial institutions implement strict financial regulations and require reasonable collateral for the loans (Andrieu & Groh, 2012; Behrens *et al.*, 2012), most of them find it difficult and are unable to meet those criteria in order to obtain loans from those institutions (Chua *et al.*, 2011).

Given the need for financial intermediaries for start-up and business expansion, the venture capital organization acts as an in between to fill this void in business financing (Vinturella & Erickson, 2013). According to Allen and Hevert (2007), the American Research and Development, founded in Massachusetts in 1946, was the first modern venture capital association. Venture capital is especially attractive because its equity finance structure gives companies the necessary leeway in their repayment schedule (Winton & Yerramilli, 2008). In addition, by focusing on start-up, venture capital firms achieve expertise and economies of scale in locating and financing potentially successful start-up ventures.

2.7 VENTURE CAPITAL IN MALAYSIA: INDUSTRY BACKGROUND

Malaysia's venture capital industry was formally set up in 1984 with the establishment of Malaysian Ventures Sdn. Bhd. by Singapore's South East Asia Venture Investment (SEAVI). But the industry's development was slow with no new entrants until 1989 when Southern Bank Bhd. established its own venture capital arm, S.B. Venture Capital Corp. Sdn. Bhd. (Sambasivan, Abdul & Yusop, 2009; Wong, 2009).

The Malaysian government's decision to allocate RM115 million for venture capital financing in 1991 marked the starting point for the government efforts in fostering the development of the local venture capital industry seriously. The capital pool rocketed from RM54 million in 1991 to RM5.347 billion by year-end 2009 (Malaysian Venture Capital Development Council, MVCDC), (www.mvcdc.com.my). The Malaysian government provided funds to finance high technology-based small and medium sized industries involved in R&D, commercialization and product development.

The Malaysian government then took another step by sponsoring the establishment of two venture capital companies: Malaysian Technology Development Corporation Sdn. Bhd. (MTDC) and Perbadanan Usahawan Nasional Berhad (PUNB). The former invests primarily in new technology-based companies and facilitates commercial opportunities for research and technology. The latter provides venture financing and other value added services to potential Bumiputera entrepreneurs. Meanwhile, the Malaysian Venture Capital and Private Equity Association (MVCA) was set up in 1995 to help in coordinating the venture capital companies operations and activities in Malaysia (Li & Zahra, 2012; Wong, 2009).

Considering the consequence of venture capital industry in stirring the nation's economic growth, the Malaysia government has established another government owned and the largest venture capital firm called Malaysia Venture Capital Management Bhd. (MAVCAP) in 2001 to realize the government's mission to support Malaysian based ICT companies as well as the local venture capital industry development. In addition, another Government-owned company, Kumpulan Modal Perdana Sdn. Bhd. Came on board to direct the venture capital fund for technology acquisitions amounting to RM190 million (Wong, 2009).

In the same year, in order to achieve efficiency and effectiveness in the development and expansion of venture capital industry, the government approved the establishment of a one-stop agency to ensure strict control. It was perceived that having one-stop agency will help in the smoothening process of formulation, coordination and monitoring all strategies, policies, incentives and simultaneously oversee the development of the venture capital industry. Preceding this, an interim coordinating body called the Venture Capital Consultative Council (VCCC) was established in August 2002 under the watch of the National Economic Action Council (NEAC) for a period of three years, with MVCA as its secretariat. This was intended to serve as a means for discussing and addressing issues relating to the industry and other related matters. However, in January 2004, it was decided that the VCCC be dissolved and replaced by a one-stop agency named Malaysian Venture Capital Development Council (MVCDC), under the purview of the Security Commission (SC) (Malaysian Venture Capital Development Council, www.mvcdc.com.my).

One of the major roles for MVCDC is to strategically chart the vision and direction for the expansion and development of the venture capital industry of Malaysian as well as an efficient implementation of relevant strategies and initiatives. As at 31st. December 2012, MVCDC has 112 registered members that comprise of venture capital management funds and venture capital management companies from various investment sectors. Out of the 112 registered members, 100 of them were locally incorporated companies, 10 were joint ventures and 2 were foreign owned venture capital management companies (Malaysian Venture Capital Development Council, www.mvcdc.com.my).

Figure 2.6 shows the total domestic venture capital investments from year 2000 to 2012. As shown in Figure 2.6, the total domestic venture capital investments rose significantly starting from year 2004 to 2012 before slightly dropped in the year 2012. In year 2000, the total domestic venture capital investment was only RM131.3 million. However, this amount rocketed to RM289.3 million in year 2004, an increase of more than 120% from year 2000 total venture capital investments. The growth of the domestic venture capital investments continues when the amount doubled to RM431.5 million in the following year.

Furthermore, Figure 2.6 demonstrates that the total domestic venture capital investments continue to show an ascending trend when the total domestic venture capital investments made in the year 2006 was RM1.159 billion. The total domestic venture capital investment of RM1.159 billion in 2006 represents a 169% increase from the total investment made in the year 2005. The significant growth of venture capital investment amount during this period was fostered mainly by the investments made by the Malaysian government through their venture capital agencies. The upward trend in domestic venture capital investments remains in the year 2007 when the total investment made rose to RM1.784 billion before becoming RM1.929 billion in the following year. This amount later reached its highest point in the year 2011 when RM3.586 billion were invested before the amount slightly dropped in the year 2012 when the total investments made were only RM2.757 billion.

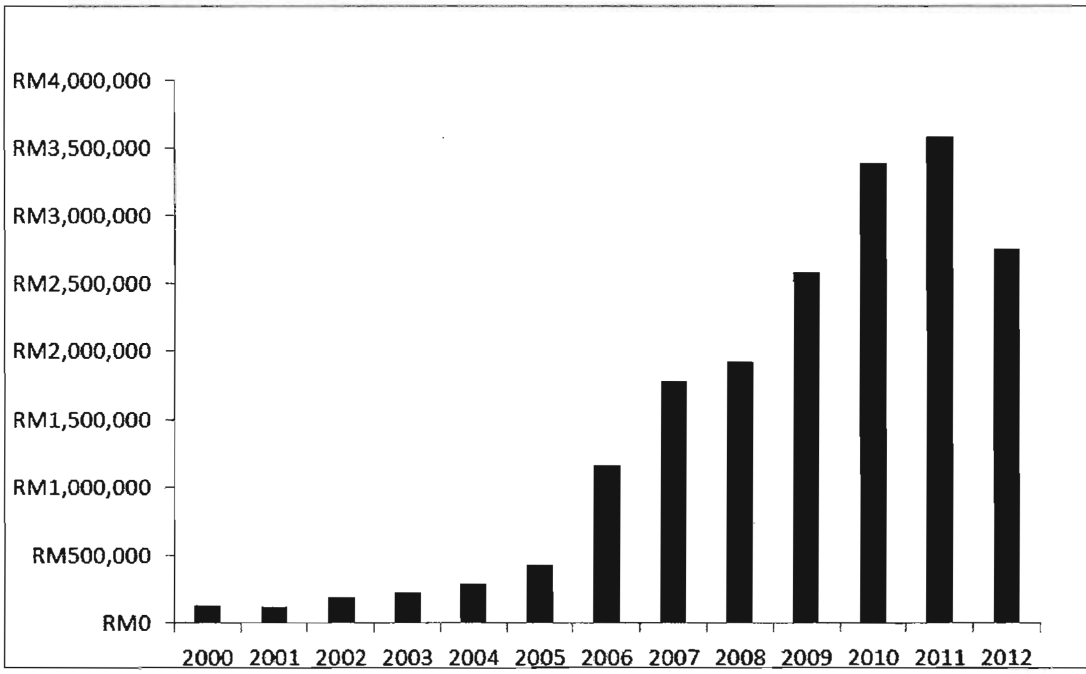


Figure 2.6
Total Yearly Domestic Venture Capital Investments (2000 – 2012)
Source: Malaysian Venture Capital Development Council, 2012

2.7.1 Overall Analysis on the Malaysian Venture Capital Investments (2000-2012)

Venture capital investment in Malaysia grew tremendously during the last ten year period. The total venture capital investment amount has grown from RM131.3 million in year 2000 to RM2.757 billion in 2012 as shown in Figure 2.6. ICT, life science and manufacturing sectors remain as the Malaysian venture capitalists favorite investment sectors for the last ten years. From all these three sectors, ICT has become the uppermost investment sector from year 2001 until 2006 before dropping significantly starting from year 2007 afterwards. At the same time, total venture capital funds available for investments were also shown an ascending pattern for the last seven consecutive years as shown in Figure 2.7.

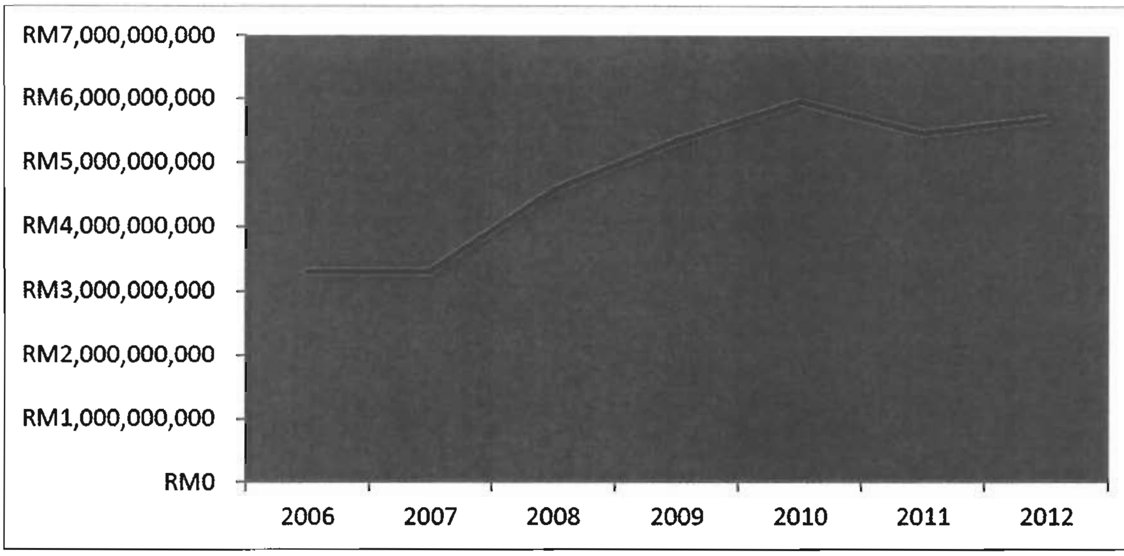


Figure 2.7
The Amount of Venture Capital Funds Available for Investments (2006-2012)
Source: Malaysian Venture Capital Development Council, 2012

At the other hand, the total venture capital investments in the life science sector have grown steadily since the year 2001. From year 2009 until 2011, life science dominated the total domestic venture capital investments along with ICT and manufacturing sector. During the year 2011, almost 50% of the total domestic venture capital investments was allocated to life science sector by the Malaysian venture capitalists. Medical and pharmaceutical sector received 27.4% from the total domestic venture capital investments in the year 2002.

Starting from year 2006, sub sectors like education, finance, transportation, trading, electricity and power generation were grouped together under Others sector. Total venture capital investments in Others sector were seen to be fluctuated during the last ten years. Others sector recorded the highest venture capital investment amount in the year 2007 when it dominated 46.6% of the total domestic venture capital investments. However the percentage of venture capital investment in Others sector dropped to only 36.1% in the year 2008 and finally remain at 19.7% in the year 2011.

Figure 2.8 shows the percentage of total domestic venture capital investment in ICT, life science, medical and pharmaceutical, manufacturing and others sectors from year 2001 until 2011.

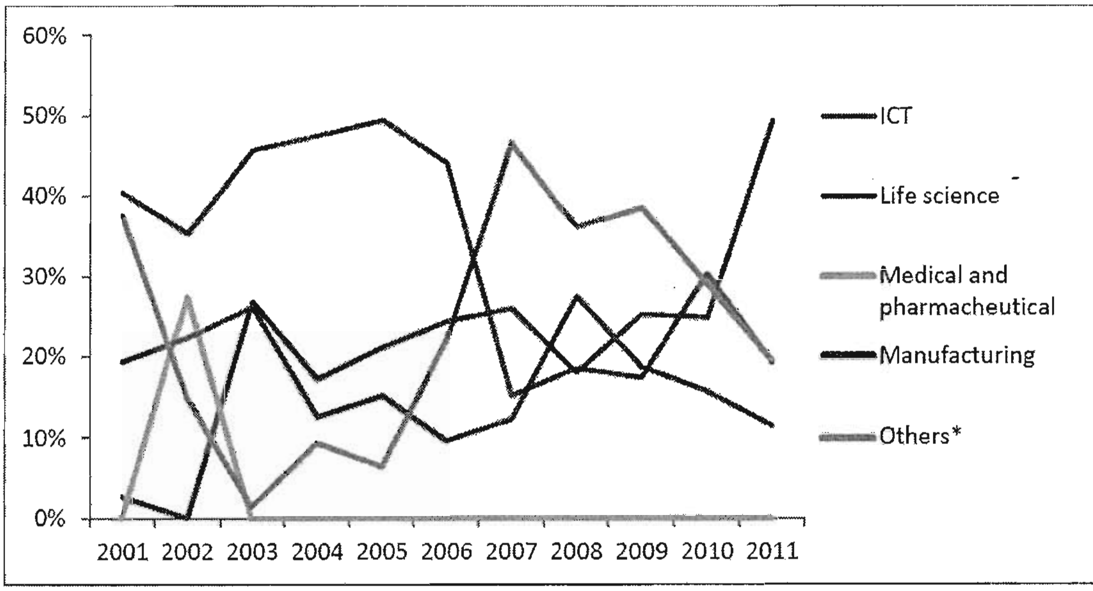


Figure 2.8
Domestic Venture Capital Investments by Sector (2001-2011)
Source: Malaysian Venture Capital Development Council, 2012

2.7.2 Overall Analysis of the Domestic Venture Capital Sources of Funds (2002-2012)

The Malaysian government remains as the major venture capital funds contributor in Malaysia for the last ten consecutive years. The Malaysian government is seen to be very optimistic with the domestic venture capital investment prospect. This can be seen when the government steadily allocated funds for venture capital investments for the last ten years. Beginning in year 2009, the Malaysian government venture capital fund contribution was found to be above half of the total venture capital funds for the local market. This is followed by the local corporations and other groups which comprise of local banks, local insurance companies, pension and provident funds, private individuals, foreign companies and other private sector entities. Figure

2.9 shows the Malaysian venture capital industry sources of funds from year 2002 to 2012.

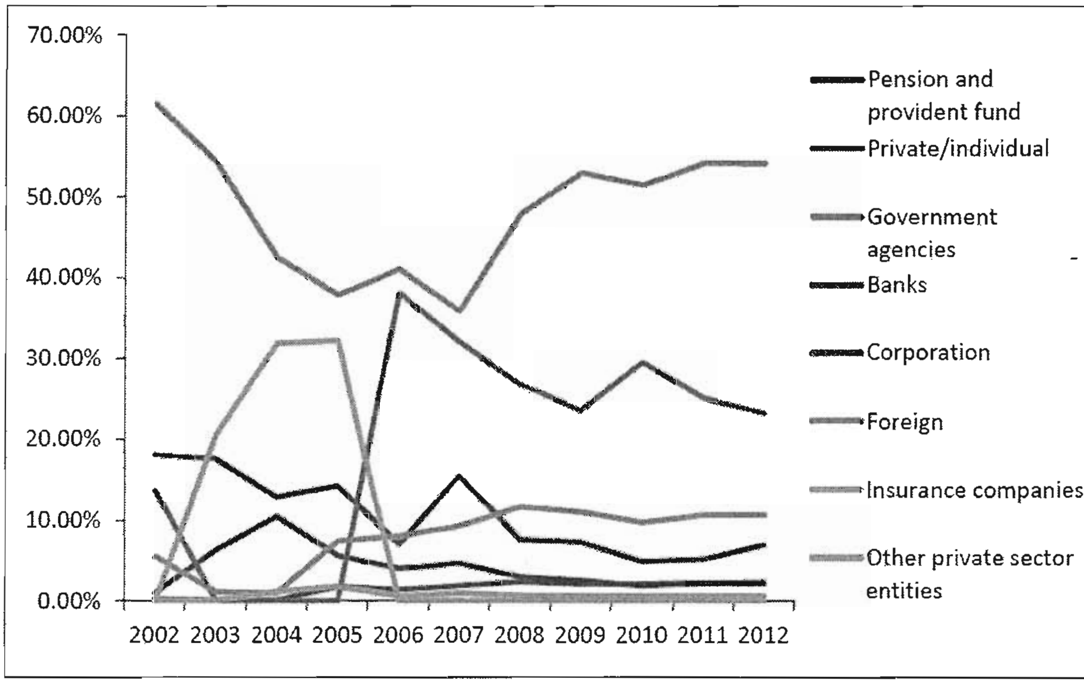


Figure 2.9
Malaysian Venture Capital Industry Sources of Funds from Year 2000 to 2012
Source: Malaysian Venture Capital Development Council, 2012

2.8 ISSUES ARISES FROM VENTURE CAPITAL FINANCING

In a situation where investee firms receive external equity funding, requirement for a division of ownership and control, including the stakeholder's diversity also exist, which are bound to govern the venture businesses management (Alsos *et al.*, 2011). Moreover, with the expected difference in the expertise areas between venture capitalists and investee firms engaging in venture businesses, they shall undoubtedly met some disagreement in running their venture business. Therefore, it is implies that, the contracted parties involved in this kind of business relationship shall have to plan their business resources and managerial factors for their venture business to success (Zu & Kaynak, 2012; Mustapha & Ahmad, 2011).

Management conflict would occur among the venture capitalists and the investee firms in venture capital financing as a result of the information asymmetries between the financiers and their investee firms (Mavlanova *et al.*, 2012; Autore & Kovacs, 2010). The conflict is also linked to adverse selection and moral hazard problems (Yung & Zender, 2010; Jewitt *et al.*, 2008). Adverse selection refers to the misrepresentation made by the venture capitalists and investee firms as to their real talents. Adverse selection occurs as a result of either venture capitalists or investee firms could not perfectly check and confirm the other party's capabilities in their business relationship (Wendels, Keienburg & Sievers, 2011). For instance, either the venture capitalists or investee firms may be referred to as professionals in their various disciplines. However, the extent to this can be relied on depends on the actual circumstances within the period they both run the business.

Moral hazard emerges once the venture capitalists and investee firms do not wholeheartedly employed their efforts as what have been decided in the venture financial contract or once they work for their individual benefits by reserving or altering vital information regarding the venture business (Yung & Zender, 2010; Jewitt *et al.*, 2008; Sohaimi, 2004). For instance, the investee firms are supposed to have more knowledge and information on their products and services technological aspect than the venture capitalists. Hence, the investee firms could possibly hold back some vital technological information that could affect their venture business success.

Management conflict may also promote challenges and at the same time heightened peoples' attention and efforts (Ozkalp *et al.*, 2009). However, severe or devastating conflict may also result in chaos in a venture business (Gimmon *et al.*, 2011; Yitshaki, 2008; Sohaimi, 2004). The management rationality assumption, whereby the venture capitalists and investee firms can see their venture firm objectives and could respond reasonably implies an adequate means of encouraging collaboration and achievement in the business. However, the realities and some related evidences confirm the basic statement to be a fictional indeed (Gimmon *et al.*, 2011). In this case, four key obstacles exist in the venture capitalists and investee firms' venture cooperation that have the potential to directly influence the venture business established. They are as follows:

(i) measurement uncertainty (a high degree of uncertainty in evaluating how well both venture capitalists and investee firms are performing),

(ii) goal incongruity (the chosen methods and specifications might be different between venture capitalists and investee firms),

(iii) information asymmetry between venture capitalists and investee firms, and

(iv) risk aversion that affects venture capitalists and investee firms venture performance.

The research on the determinants of management conflict between the venture capitalists and the investee firms with a particular attention on the post investment phase of the process of venture capital was conducted by Yitshaki (2008) and Sohaimi (2004) based on the previous works by Higashide and Birley (2002). The study by Higashide and Birley (2002) in the U.K found that conflict as disagreements between the venture capitalists and investee firms would be of benefits to the venture business performance. However, conflict as personal friction was revealed to negatively correlate with venture performance. Furthermore, they also stressed the importance of managing conflict at the pre-investment stage (e. g. due diligence and deal structuring processes) and also at the post investment stages.

Additionally, there are contextual elements influencing venture capitalists and investee firm's relationship which is deemed to be largely related to agency risk, business/market risk, the uncertainty in assigned task and influential degree (Abbasi, 2009; Li, 2008). Agency risks are associated to the possibility that whether the venture capitalists or investee firms will act opposing to the desires of each other. Business or market risks are related to the venture businesses uncertainty with reference to the business environment where both venture capitalists and investee firms operate, that affects their venture business competitiveness (Bengtsson & Sensoy, 2011). The uncertainty in the assigned task indicates the difference between the information available to decision makers and the information necessary to make effective decisions (Chahine, Arthurs, Filatotchev & Hoskisson, 2012). The extent of association is the actual shareholding percentage of each stakeholder in the venture business. The influential degree determines the level of influence that each stakeholder has on the venture business (Leisen, 2012).

According to Yitshaki (2008), the conflict between venture capitalists and investee firms occur in three aspects namely procedural, contextual and contractual. The contractual conflict refers to the conflict resulted from the disagreements of venture capitalists and entrepreneurs over the contractual arrangement when each party attempts to not obeying the terms agreed in the financing contract due to the dissatisfaction perceived by them. On the other hand, the contextual conflict occurs in the context of venture capitalists – entrepreneur's relationship when the entrepreneurs perceived the high participation of financiers in the business as a threat. The high participation of financiers in the entrepreneur's enterprises may be perceived as a threat when the actions taken by venture capitalists (the financier) are not in line with the entrepreneurs' aspiration.

The procedural conflict is related to information exchange uphold by the two contracting parties involved in interorganizational relationship. According to this dimension, conflict may occur when the parties involved in the interorganizational relationships failed to maintain the exchanges of information needed due to certain factors such as lack of trust between each other and information asymmetry (Yitshaki, 2008). In the venture capital investment context, the procedural conflict may occur when the entrepreneurs are perceived by the venture capitalists to be unwilling to share the information needed by them. Such conflict may bring harm not only to both venture capitalists and entrepreneurs, but it also may prevent those parties from achieving the target to create successful ventures (Gimmon *et al.*, 2011).

The second conflict dimension, which is contextual conflict, is highly related with the research framework and yet to be included in the previous study. The contextual conflict here refers to the conflict that arise due to the dissatisfaction felt by the entrepreneurs due to the controlling mechanism employed by the venture capitalists in the investee firms by placing a nominee director in the firms' board of directors. The nominee director is placed in the investee firms' board to foresee the firms' operation and to protect venture capitalists investment interests (Boxer *et al.*, 2012). The controlling mechanism may trigger management conflict between venture capitalists and their investee firms once their involvement in the investee firms' management through the roles played by their nominee director reached a level which the investee firms' management are not willing to accept and tolerate and at the same time is perceived as a threat by them.

2.9 APPROACH IN SOLVING CONFLICT ARISES FROM VENTURE CAPITAL FINANCING

The monitoring and other post investment activities begin once venture capital funds have been released to the successful applicants. This is the beginning of a series of monitoring activities where venture capitalists will supervise and provide necessary assistance to their investees to help them perform their operation and achieve their ultimate business goals towards creating a successful venture business (Campbell II & Frye, 2009; Klonowski, 2007). However, the possibility of having different opinions and stands may still exist between venture capitalists and their investees in their venture cooperation (Yitshaki, 2008). These differences, if not well addressed will soon become conflict which consequently may harm and prevent both venture capitalists and their investees from creating successful venture businesses (Miller & Wesley, 2010). Therefore, most venture capitalists have taken proactive actions by utilizing several mechanisms to solve or reduce any management conflict occurred between them and their investees.

Mechanisms utilized to mitigate management conflict in venture capital financing have been explored in depth by scholars in a series of theoretical studies. These studies include topics that relates to various managerial aspects in venture capital financing such as active monitoring (Campbell II & Frye, 2009; Chowdhury, 2009), exchanging accounting and strategic information (Gimmon *et al.*, 2011), screening mechanisms (Croce, Martí & Murtinu, 2013; Casamatta & Haritchabalet, 2007), exit incentives (Collewaert, 2012; Dai *et al.,* 2012; Annamalai & Deshmukh, 2011; Bienz & Walz, 2010), proper syndicating of financing (Chahine *et al.*, 2012), and staging of actual financing (Dahiya & Ray, 2012; Leisen, 2012; Tian, 2011). Several of these studies are discussed in the following section. However, the studies' findings seem to be inconclusive since many of the research failed to give considerable attention to aspects of the characteristics and nature of the key stakeholders. Additionally, the majority of the above research works believe that the venture business key stakeholders are relatively homogenous in terms of their risk preferences and expertise.

In most of the cases, the venture capitalist's vital role is to generate information about the prospects of the investee firms (Miller & Wesley, 2010). Even though such an emphasis is important, it does not contribute much in explaining the additional functions of the key stakeholders' managerial factors that affect the strategies of decreasing management conflict. Therefore, it is justified to comprehend their real managerial factors where the nature of management conflict between the venture business key stakeholders is a result of their characteristics.

Staged financing seems to be the most convincing control tool venture capitalists may utilize. This mechanism requires the prospects of the investee firms to be regularly re-examined. The shorter the period of the stage financing, the greater the opportunity that the venture capitalists will have in monitoring their investee firms' progress (Dahiya & Ray, 2012; Leisen, 2012; Tian, 2011). Among the mechanisms that commonly used by the financiers are the staging of financing, stock grants and stock alternative, informal monitoring and controls and extra benefit controls to decrease the possibility of shirking or gaming by the investee firms (Essid, 2012; Brockman, Martin & Puckett, 2010).

In line with the previous studies by Gompers and Lerner (1999), and Gimmon *et al.* (2011), they argued the non-monetary sides of venture capital that determines its success. Gompers and Lerner (1999) studied staging financing in the U.S. The study findings show that the staging of financing permits venture capitalists to collect original evidence and at the same time monitor their venture businesses progress. In addition to this, the tool equally permits the venture capitalists to uphold the alternative to maintain the option to leave the enterprises regularly. Accordingly, Gompers and Lerner (1999) concurred that increment in asset tangibility leads to an increment in financing time period and consequently decrease screening intensity.

Achleitner *et al.* (2013) had conducted another study to explore venture performance and venture capitalists' monitoring of investee firms in the U.S. Their findings show that although venture capitalists are rarely participating in the daily controlling of the venture, they normally will re-evaluate the investee enterprises' progress between financings to scope or prevent any opportunistic behavior by the investee firms between assessments.

In another study conducted by Campbell II and Frye (2009), they compared the U.S. and Japanese venture capitalists monitoring techniques in the U.S. market. Their findings show that the United States' venture capitalists are having greater opportunity to have better motivation and capability to oversee their investee firms than the Japanese venture capitalists who have a tendency to make less investment but take a bigger equity stake. Furthermore, the close formal monitoring techniques are also found to be not too predominant in the Japanese market.

Besides staged financing, another tool utilized to mitigate management conflict in venture capital financing is a proper syndication of financing. Casamatta and Haritchabalet (2007) developed the reason for financing syndication especially in the later venture financing part which is rely on informational asymmetries concerning the initial venture capitalists and other prospective investors. According to them, one major means to avoid any opportunistic behavior by the investee firms is by maintaining a significant shareholding in the investee firms' equity by the lead venture capitalist.

Based on the studies above, Legrand and Pommet (2010) argue that venture capitalists have developed various tools to solve management conflict that appears in each phase of the venture capital financing process. These tools are meeting out financing in separate phases over the period, having positions on the investee firms' board of directors, syndicating investments with other venture capitalists and compensating arrangements which include stock options (Terjesen, Patel, Fiet & D'Souza, 2013; Tang, 2012; Dimov & Milanov, 2010; Long *et al.,* 2005).

2.10 UNDERPINNING THEORIES

The discussions on the conflict between venture capitalists and entrepreneurs in venture cooperation and the approach utilized to minimize the conflict occurred have led to the needs to understand the theoretical aspects which act as the fundamental in understanding the nature of conflict between the two contracted parties. According to Curi (2012), theory should be a systematic attempt to understand what is observable. Thus, a theory should create order and logic from the observed facts, although it may appear disorderly and disconnected. Many other researchers such as Galichon and Henry (2012) and Haggarty, Ferguson, Scott, Iroegbu and Stidson (2010) explain that ideally good theory should have both explanatory value as well as predictive value.

This indicates that the conceptual framework has to be explained or understand from the causal law, not only from the adequate description and observable phenomenon. In an ideal world, a theory must identify relevant variables and the connections between these variables. Then, testable hypotheses have to be generated and empirically established (Sekaran & Bougie, 2013). Ott (2013) goes further by suggesting that theories can also play a critical role in simplifying the relationship among explained variables. Therefore, this research has chosen three economic theories which act as the foundation for the subjects that are being studied. As mentioned earlier and to explain on the selection, the following two economic theories have been selected for the study:

(i) Agency Theory (Principal – Agent Problem),

(ii) Theory of the Firm, and

(iii) Stakeholder Theory

The explanation and summaries for each of the theories selected will not be thorough. Nevertheless, they are the research's foundation theories as they become the starting point in understanding the whole framework of venture capital financing to entrepreneur. In providing justification for the selection of the theories as the foundation theories, the following reasons are given:

(i) venture capital is a unique sector and it has direct influence on the firm development process,

(ii) the core fundamentals in the Theory of the Firm are critically required to provide relationship pertaining to venture capital that has the contractual aspects in the business relationship, and

(iii) the differences between these taking and not taking financings from venture capitalists can be identified from the viewpoint of these three theories.

Moreover, the empirical investigation in the area of venture capital shall add strength and solidity to the theory from the perspective of data source, which is from the developing and the unique culture society found in Malaysia.

2.10.1 The Agency Theory (Principal – Agent Problem)

The applied principal-agent analysis framework is employed in this research. Hence, a concise argument on the Agency Theory as the main theory is believed to be necessary and justified. This is in line with Fayezi, O'Loughlin and Zutshi (2012), Zu and Kaynak (2012), and Abbasi (2009) who suggest that the problem is dealt with the difficulties arise under the conditions of incomplete or asymmetric information between principal and agent. According to Mitchell and Meacheam (2011), the principal – agent problem occurs once the agent's started to act on behalf of his/her interest and not on behalf of the principal's interest.

Various mechanisms are used in the effort to align the agent's interests in solidarity with the principal. Such tools, such as commission percentage, profit sharing, wages efficiency and performance measurement are utilized in minimizing the possibility of conflict of interest to occur between an agent and a principal. This is suggested by Fleming and Schaupp (2012), Spector and Spital (2011), and Tortella, Mejia, Castro and Wiseman (2005) where they highlight that such problems exist in most employer/employee relationship.

In economic literature, from one perspective, investee firms are described in dynamic variants. For instance, they are described as decision makers, risk takers, organizers, innovators and economic resource managers. However, it is argued here that investee firms rarely have sufficient financing to help them in ensuring the success of their business (Minai & Lucky, 2011). For Mohammad *et al.* (2014), venture capitalists are the specialized financial institutions that provide high risk capital to these investee firms. Both venture capitalists (as the principal) and investee firms (as the agent) are the main players in the business that they have ventured together. There is high possibility that an agency relationship exists between both of these two parties.

Principally, the Agency Theory focuses on the probability of having opposing interests or views between the principal and the agent. According to Mitchell and Meacheam (2011), Bonazzi and Islam (2007), and Eisenhardt (1989), this theory also relies on the assumption of market efficiency. The Agency Theory proposes that one of the ways to overcome the opportunistic behaviors (the principal as the financiers and the agent as the investee firms) is by monitoring the agent. This theory highlights that the principal (venture capitalists) and the agent (investee firms) have different self-interest (Hypko, Tilebein & Gleich, 2010). Thus, if the investee firm wants to succeed in obtaining the resources needed, the firm has to provide to the venture capitalist the satisfactory incentives. This can be achieved by compensating the venture capitalists for their different interests.

The Agency Theory also contends that agency conflict arises due to information asymmetries or uncertainty when examining their relationship. This theory's fundamental issue is pertaining to information asymmetries as highlighted by Jensen and Meckling (1976). In the venture capitalists and investee firms' relationship, the problem arises from the difficulty when the investee firms possessed more information related to the venture business than venture capitalists.

For the case of venture capitalists in Malaysia, the industry is still in the developing stage. Thus, there is a sizeable information gap regarding their financial aspects (Minai & Lucky, 2012). Therefore, with regards to these conditions and some theory underlying assumptions discussed above, the Agency Theory is considered suitable to be used in this study. This is because the theory is believed to have the capacity to address management conflict relating to information and expectation problems met by both venture capitalists and investee firms in the venture business they have together ventured into. The illustration of the Agency Theory is shown in Figure 2.10.

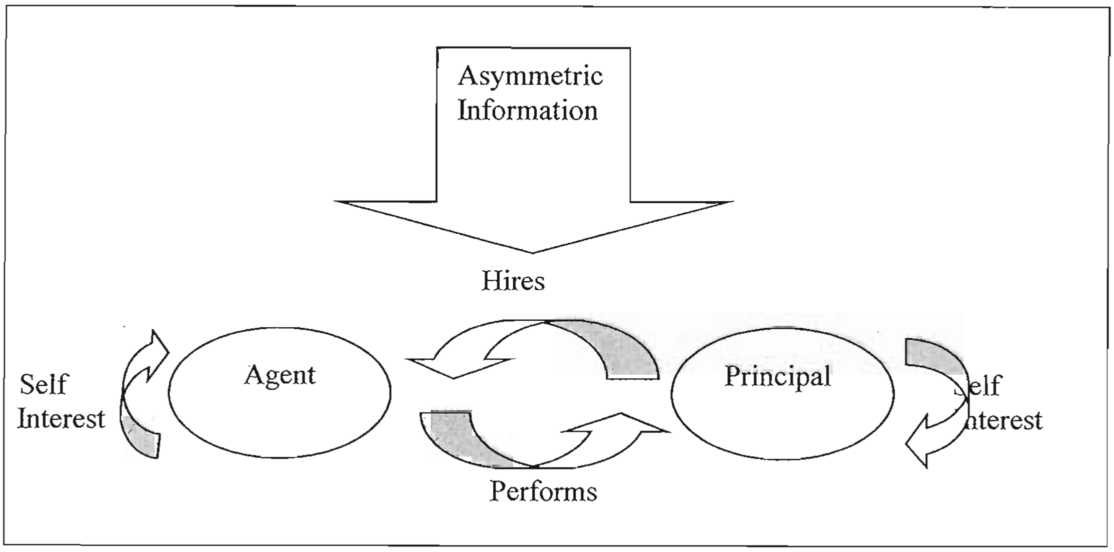


Figure 2.10
The Agency Theory Diagram
Source: Tate *et al.*, 2010

2.10.1.1 The Principal – Agent Analysis

The research opts for the applied principal agent analysis as the reference framework to analyze the relationship between venture capitalists and investee firms' business. Fundamentally, in an agency relationship, one party performs the tasks on behalf of another party. In the examined relationship, the venture capitalists (the financiers) are treated as the principal whilst the investee firms are treated as the agent in this research. Since the investee firms are the shareholders of the venture business, they are thus considered as the principal within this context.

It can be observed that some changes occur where the investee firm is seemed as an agent when the financial contract is signed. This is evidenced when the venture capitalists invest additional equity required by the investee firms from time to time after the initial agreement is signed. Moreover, information asymmetries arise during the venture relationship leads toward agency conflict pertaining to the managerial aspects between the involved parties.

Below are the justifications for using the principal agent analysis as the reference framework:

(i) It is argued here that this framework has the ability to view the complexity in this relationship, which is the venture business and the financial contracts.

(ii) This framework seems to have the capability of investigating both the views of venture capitalists and of investee firms concurrently.

(iii) The framework also seems to have the ability to explain the reality of principal agent relationship. It is important that such reality to be explained clearly so that the understanding in this matter can clarify the way conflict emerges and the potential way to address such issue.

Moreover, Kaskarelis (2010) and Sohaimi (2004) have indicated now that this framework has the potential and have suggested this framework to be utilized in analyzing the venture contract. Sohaimi (2004) concisely contends that the principal agent analysis provides an influential overarching for analyzing contractual relations.

This refers to the contracted parties where both risk and incomplete knowledge of actions involve.

2.10.2 Theory of the Firm

The theory of the firm concise of several economic theories which describes the nature, existence, relationship to the market and the behavior of the firm, company or corporation, (Kállay, 2012; Sohaimi, 2004). The theory's core tenets comprises of:

(i) The entrepreneur – An economic man, which makes rational decision,

(ii) there is no uncertainty in the business environment,

(iii) perfect and faultless information is widely available in the marketplace, and

(iv) maximizing profit is the firm's only objective.

The Theory of the Firm has become a debate topic among the worldwide economists when many of them strongly argue that this theory should be assessed strictly only on its projecting power and not on the practicality of its assumptions (Steen, 2010; Sison, 2007). The theory's tenets strongly assume that all economic units may act perfectly in a perfect world when in reality, those assumptions are not fully true and realistic due to the human nature and market imperfection (Augier & March, 2008). Therefore, most organizational theorists have proposed to incorporate the Theory of the Firm with the managerial and behavioral aspects since the theory itself must have the ability to recognize the existence of multiple firm objectives to make it looks more realistic (Lee, 2010; Alvarez, 2007).

For instance, human decision making is a complex cognitive process. Hence, many variables and considerations need to be thoroughly evaluated before a final decision can be decided. In most of the cases, people tend to be influenced by many factors which may result the final decisions to be irrational (Bazerman & Moore, 2009). The study on the behavior of human decision making in the problem solving context by Kim, Yang and Kim (2008) revealed that there are three unique phases involved in the activities, namely:

(i) intelligence activities – decisions are made based on the environmental screening,
(ii) design activity – the action progress is analyzed, and
(iii) choice of activity – selecting a definite act.

The decision makers commonly opt for the bounded rationality principle instead of perfect rationality when making a decision. An individual judgment is confined to the rationality of the decision. It is easier to understand a certain decision making by explaining the actual decisions instead of looking at the prescriptive decision analysis alone (Kim *et al.*, 2008). Rivière and David (2013) see the firm as integration of various stakeholders from inside and outside of the firm and then said that the firm in fact does not run in a vacuum. This suggests that the firm itself does not have its own objective. The numerous objectives of the firm stakeholders' are arranged by a dealing process.

According to the literatures discussed above, the behavioral and managerial theories of the firm highlight the inner processes and behavioral factors which will influence the decisions made by the firm and its management. This argument is backed by the truth that in the real world, the firm's management decisions are highly dependent on the real business situation such as the risks and the growth rates of the market, technical opportunities and risks associated with them, the presence of competitors and their reactions, entry barriers and others (Zhang, Kuwano, Lee & Fujiwara, 2009; Bromiley, 1986; Porter, 1985).

2.10.3 Stakeholder Theory

The other important firm's concept that has a relationship with the ownership and separation of control issues as argued in the previous section is the Stakeholder Theory. The Stakeholder Theory involves the organizational management and business ethics by focusing on the morals and values to manage a business (Lafreniere, Deshpande, Bjornlund & Hunter, 2013; Tullberg, 2013; Bae, Kang & Wang, 2011). The Stakeholder Theory suggests that there are numerous groups (as shown in Figure 3.2) that could be affected by the firm's performance. Therefore, they should be considered while determining the firm's goals and while managing the firm's strategic management function. This means that the firm will not only have to consider the various stakeholders, but also other groups while focusing on the fundamental economic objectives, (Jurgens *et al.*, 2010). Primarily, the definition of stakeholder includes shareholders, managers, employees, buyers, suppliers, customers, financiers, communities, political groups, government, trade associations and investors. Their loyalty is vital to the firm's survival (Mahadeo *et al.*, 2011).

The firm's objectives ought to be derived from balancing its diverse stakeholders conflicting objectives (Vilanova, 2007). Furthermore, the cause of the appearance of this theory is because of the difficulty in managing the firm's constraints and responsibilities in relation to the various stakeholders (Kamal, Weerakkody & Irani, 2011). Along similar lines, it is argued that the firm's stakeholders are one of the serious test/trial to come across by the firm. This is because the stakeholders intend to affect/brainwash/rule the firm's decision on strategic matters (Aguiar, Becker & Miller, 2013). They are sophisticated and are more anxious of the effects to their quality of life (Bossuyt, Hoyle, Tumer & Dong, 2012). Yee, Lo and Tang (2013) supported this argument and describe stakeholders as the entire parties outside or inside of an organization that are directly influenced and affected by the firm's actions. Yee *et al.* (2013) also argues that serving all of the stakeholders is one of the firm's main objectives and this is achieved by aiming to better their life status.

According to Mainardes, Alves and Raposo (2012) and Jansson (2010), stakeholders for an organization are defined as any individual or group that can influence, or is influenced by the achievement of the firm's objectives. Furthermore, Jansson (2010) also said that the Stakeholder Theory as well as other theories could be combined together to develop an approach for the firm's strategic planning.

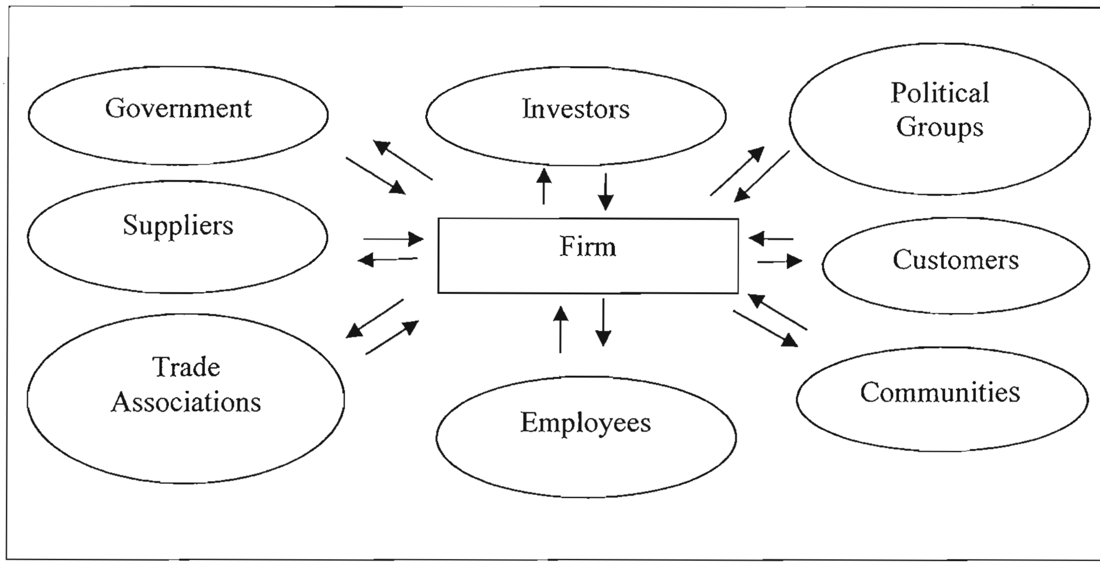


Figure 2.11
The Stakeholder Theory Diagram
Source: Donaldson and Preston, 1995

2.11 PAST RESEARCH MODEL ON VENTURE CAPITAL INVESTMENT

The discussions on the underpinning theories have led to the reviews on the research model used by past researcher. This study follows the approach by Sohaimi (2004) who examined the management conflict between venture capitalist and firms backed by venture capital financing in the Malaysian ICT sector. This is found to be the closest research work examining the conflict between the two parties. This research framework is used as the foundation to develop the framework of this study.

This framework guiding the study on the management conflict between the venture capitalist and the investee firms and highlighting the key components affecting the management conflict needed to achieve the first objective of this study. From this framework, the use of selected theories becomes evidence. The Sohaimi's (2004) research model and framework are shown in figure 2.12 and 2.13 respectively.

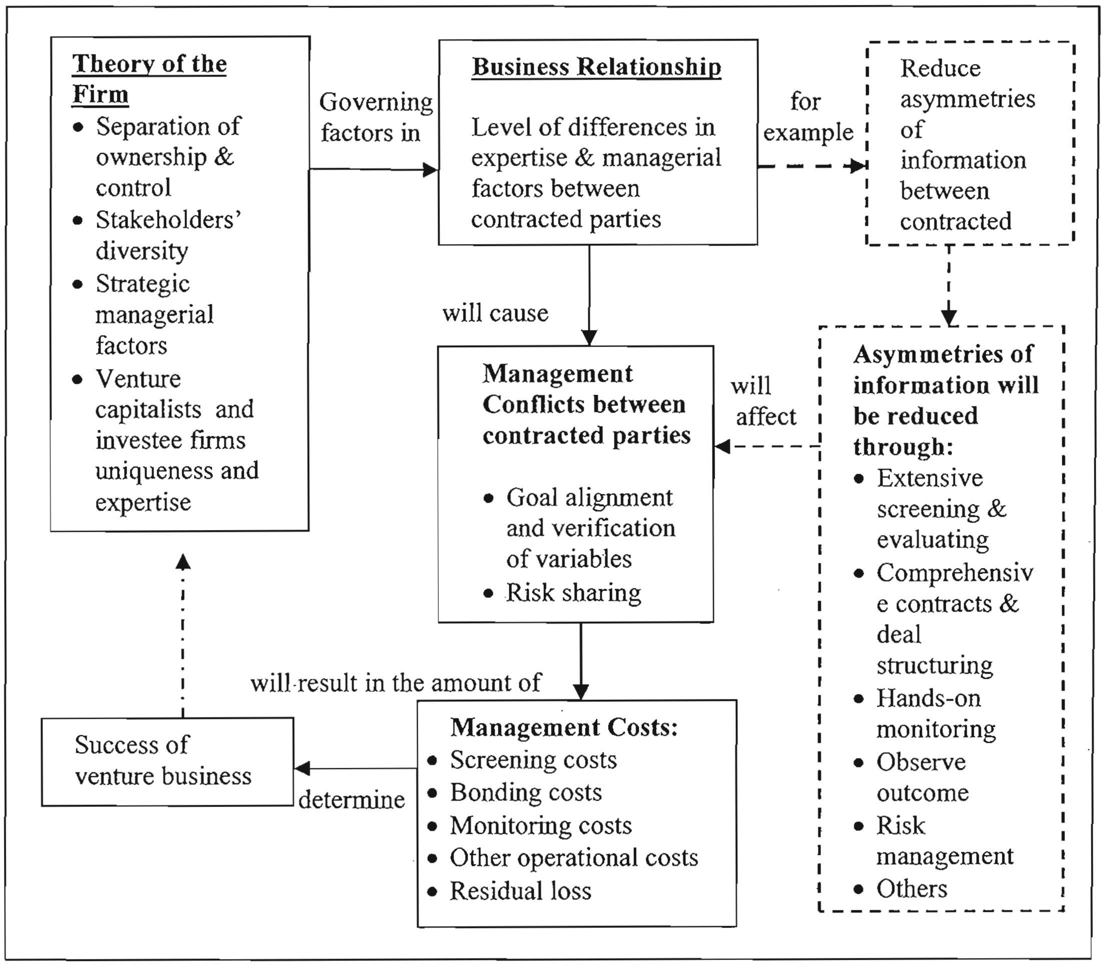


Figure 2.12
The Sohaimi Research Model
Source: Sohaimi, 2004

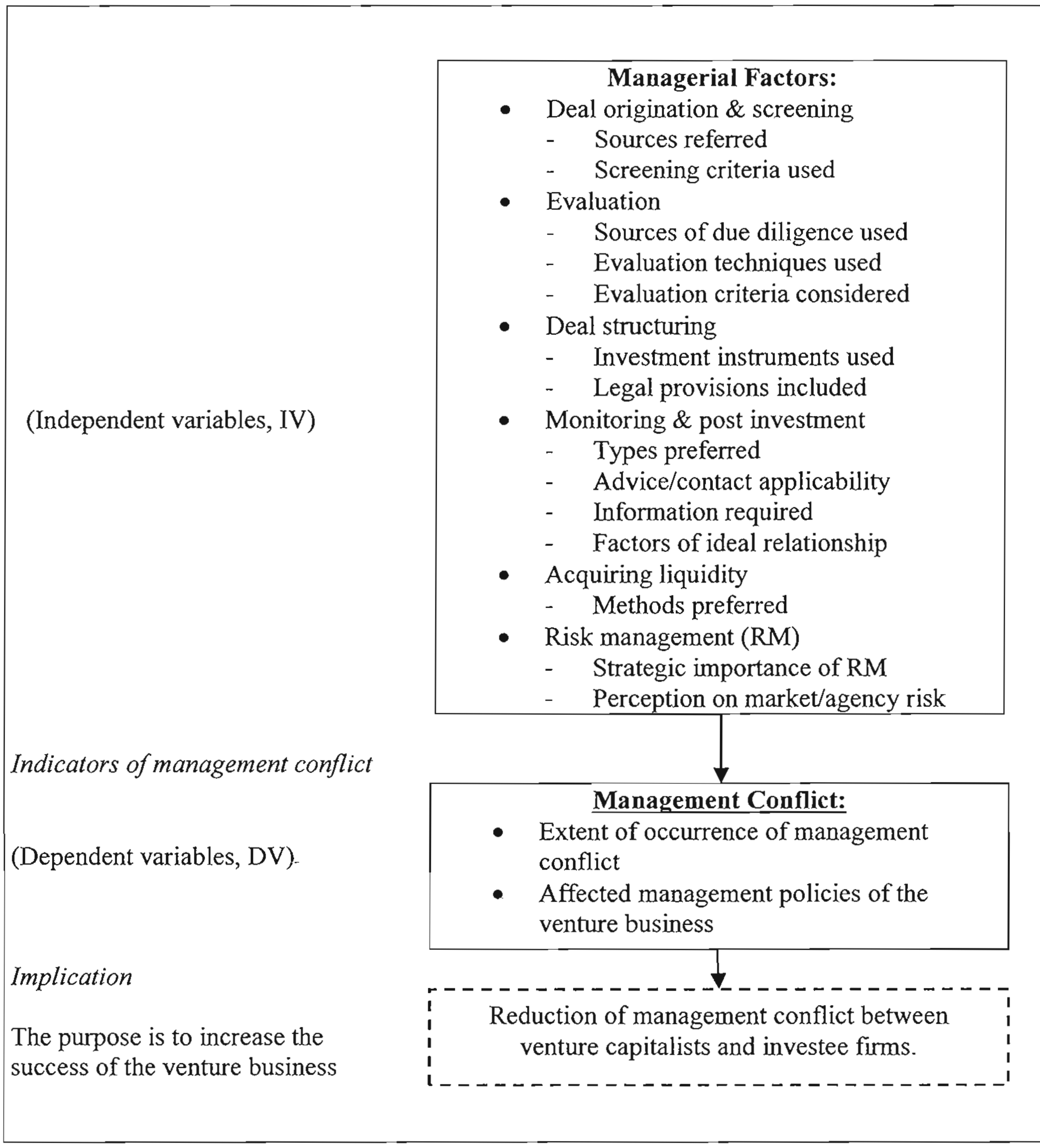


Figure 2.13
The Sohaimi Research Framework
Source: Sohaimi, 2004

From the research model by Sohaimi (2004), the management conflict between the venture capitalists and the investee firms occurred due to the differences they have in terms of their expertise and managerial factors within the context of venture relationship. The research framework clearly indicates the factors representing the managerial factors. Thus, this research opts for the following general research model.

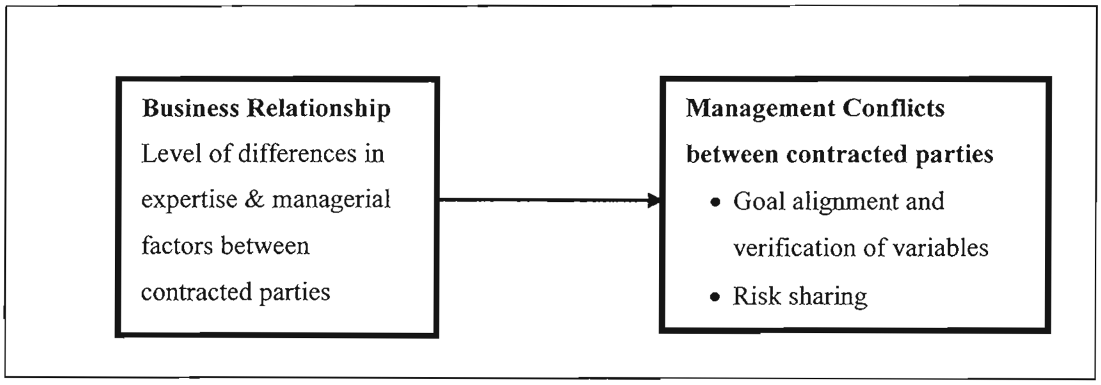


Figure 2.14
The Basis for the Research Model of this Study

Let's discuss about the research model by Sohaimi (2004) and highlight the strength of the model. The Sohaimi (2004) research model in Figure 2.12 explains the governing factors that have an impact on the venture capitalists and investee firms' venture relationship. Both venture capitalists and investee firms may have a set of unique expertise which may be different from each other (Popov & Roosenboom, 2013; Li, 2008; Zhang, 2012; Sohaimi, 2004).

For instance, the entrepreneurs may have the expertise in the product development aspect and at the same time they are also expert in the technology used for the production activities. On the other hand, the venture capitalists may have the expertise in the marketing activities and business financial management. Therefore, the differences need to be aligned towards achieving the venture ultimate goal. Venture cooperation requires both venture capitalists and the entrepreneurs to join forces together towards creating a successful venture business (Ozmel, Robinson & Stuart, 2013). The relationship between the venture capitalists and the entrepreneurs in venture cooperation is governed by the contractual agreement (Cumming *et al.*, 2010).

However, conflict seems to be unavoidable in most venture cooperation (Rosenbusch *et al.*, 2013; Gimmon *et al.*, 2011; Yitshaki, 2008). Therefore, any differences between the venture capitalists and the entrepreneurs may have high potential to trigger the management conflict to occur in the venture cooperation established between them. For instance, any disagreement between both contractual parties may lead to an argument which eventually will spark the occurrence of management conflict in venture cooperation. Furthermore, one of the other major causes that also contribute to the occurrence of management conflict in any venture cooperation is the asymmetry of information between the parties involved in the cooperation, especially on the entrepreneurs' side (Buzzacchi, Scellato & Ughetto, 2013; Prashantham & Kumar, 2011).

The existence of asymmetry of information between the venture capitalists and the investee firms has further made the relationship between them in their venture cooperation started to deteriorate since the information provided by the investee firms to the venture capitalists in the venture cooperation may not fully transparent and disclosed (Cumming & Dai, 2010). The undisclosed information may result in the venture capitalists to have invalid and insufficient information pertaining to the venture business operation (Tian, 2011). Thus, leaving the venture capitalists in a difficult situation when the information they need to assist them in making their business decision is either inappropriate or inadequate. Consequently, this situation has dragged many venture capitalists and investee firms into disastrous conflict situation (Zhang, 2012).

Management conflict between contractual parties in any venture cooperation will result the venture capitalists to incur additional costs. These costs incurred due to the need for the venture capitalists to take additional actions such as extensive venture screening, continuous venture monitoring and preparing the legal documentations in ensuring that their investment interests in the investee firms are well protected (Cumming *et al.*, 2010). Besides increasing venture capitalists' costs, the management conflict may also hinder the venture cooperation's success potential as it may prevent both the venture capitalists and the investee firms from successfully cooperating among each other towards achieving their ultimate goal to create a successful venture business (Benson & Ziedonis, 2010).

Hence, the venture capitalists have taken several precautions to reduce the information asymmetry between the contractual parties in venture cooperation. This was done via extensive screening and evaluation on the entrepreneurs besides employing a comprehensive contractual agreement between the venture capitalists and the entrepreneurs before any further commitment can be made. Also, the extensive venture monitoring activities implemented during the post investment phase may also help the venture capitalists to monitor their investee firms operation besides reducing the prospect for any opportunistic behaviors to occur among the investee firms (Butler & Goktan, 2013).

The management conflict should be reduced if the venture capitalists would like to improve the opportunity of their venture business to success (Ebbers & Wijnberg, 2012). Therefore, continuous business goal alignment will need to be carried out on the venture relationship to ensure both the venture capitalists and the investee firms are always on the right track towards creating a viable and sound venture business. At the same time, both venture capitalists and the investee firms also need to have appropriate risk and information sharing between each other. Risk and information sharing may help the venture capitalists and the investee firms to exchange useful business information which could help both parties in their business decision making process (Chua *et al.*, 2011).

All of the factors discussed above, if managed properly, shall strategically contribute to the success opportunity of venture cooperation. Firstly, from the positive point of view, the uniqueness of expertise between the venture capitalists and the entrepreneurs involved in venture cooperation could be combined together to gain competitive advantage. Secondly, any conflict and disagreement occurred due to the differences in expertise and each party unique characteristic may be handled through continuous business goal alignment besides having a strong and comprehensive contractual agreement between the contracted parties. The contractual agreement will govern the venture operation throughout the venture life. Finally, the overall venture cooperation success opportunity can be improved once each of the factors in the above model is well handled by both the venture capitalists and the entrepreneurs.

With regard to the research framework by Sohaimi (2004), it is important to review the factors associating with the variables affecting the management conflict. The Sohaimi (2004) research framework comprises of six independent variables (IVs) and one dependent variable (DV).

The independent variables in the Sohaimi (2004) research framework comprise of:

(i) Deal origination and screening

(ii) Evaluating venture proposal

(iii) Contracting and deal structuring

(iv) Monitoring and post investment activities

(v) Acquiring liquidity

(vi) Risk management

The dependent variable in the research framework consists of the management conflict. The management conflict is measured by the management conflict occurrence magnitude and the number of venture business's management policies that have been affected by the conflict occurred. The independent variables in the research model represent the venture capital managerial factors in the venture capital investment process. Managerial factors refer to the strategic managerial practices and the venture capitalists and investee firms procedures that facilitate or hinder the management and the success of their venture business. In other words, managerial factors relate to venture capitalists and investee firms explicit preferences, significance and applicability of certain managerial procedures and practices in running their venture business.

Each independent variable illustrated in the framework represents each stage in complete venture capital investment cycle, starting from deal origination and screening until the moment the venture capitalists exit their investment through acquiring liquidity. Sohaimi (2004) used the term managerial factors to refer to these six independent variables in his study.

The venture capital investment process begins with deal origination and screening. This is the process where venture capitalists run the screening process on the business proposals received from the entrepreneurs that are applying for venture capital funding. During this stage, any business proposal that has sound business ideas will be shortlisted for further evaluation, whereas the others will be rejected. This is the crucial stage and venture capital firms often rely on their counterparts such as investment bankers, brokers, consultants and lawyers to obtain related information regarding the deals besides referring from other companies those who have been successfully financed in the past (Kollmann & Kuckertz, 2010).

Venture capitalists also will have to compete directly with other parties such as investment advisory firms or brokerage house to locate any suitable candidate investee firms to be financed. Some of the most popular deal generating techniques include self-generation and direct marketing (Metrick & Yasuda, 2011; Miller & Wesley, 2010). In self-generation technique, firms seeking for capital will generally identify venture capital providers through professional advisers while in direct marketing technique, the venture capitalists' efforts are focused on identifying deals in the desired size range, industry and stage of development.

According to Cumming and Johan (2010), venture capitalists will reject any business proposals that are assumed to be unable to meet their investment criteria, have been previously unsuccessful in certain sectors and those who appear to be generally unpromising. From the various criteria used, the deal size is one of the important aspects that will be well considered by the venture capitalists during the initial screening phase, along with the applicants' production technology, venture business location, the management track record and the places where the services and products produced are going to be marketed (Bartkus *et al.*, 2013).

Business proposal that has successfully passed the initial screening phase, then will have to undergo a thorough evaluation process where they will be heavily scrutinized and evaluated (Chen, 2010). The information included in the provided business proposals and supported documents are confirmed and financial forecasts will also be well investigated. Besides, the firm's employees, customers, suppliers and creditors are also consulted to validate all the information given (Nelson, Maxfield & Kolb, 2009). The key evaluation criteria include the uniqueness of the product, environmental threat, technological advantage, management track record, market attractiveness and the investment rate of returns (Gimmon *et al.*, 2011, Klonowski, 2007). According to Jenner and Suchard (2013), though the general objective of this due diligence is to gain a thorough understanding of all business aspects, the focus of investigation may vary from deal to deal. This is the phase whereby venture capitalists professional experience is crucial in ensuring the effectiveness of the evaluation process.

The deal negotiation or deal structuring will commence once the due diligence does not identify any problems or major areas of concern. This is the stage where venture capitalists and the prospect firms will negotiate the terms included in the venture capital financing contract (Chen, Gompers, Kovner & Lerner, 2010). Generally, this contract will highlight venture capitalists and the financed firm's responsibilities, rights and liabilities and exit provisions. Besides, it also highlights the investment instruments to be used (Campbell II & Frye, 2009). This is a complex process and its complexity is widely mentioned in the academic literatures as mentioned by Klonowski (2007).

Once the deal structuring is completed, the venture capital funds will be released to the successful firms based on the agreed terms. This is the beginning point whereby venture capitalists will commence their post investment activities in ensuring their investment and the financed firms (investee firms) will always be on the right track in achieving their ultimate investment goal. Normally, venture capitalists will conduct a continuous evaluation on each of the investments previously made in ensuring the success of the business and the profits associated with it (Campbell II & Frye, 2009). In most of the cases, venture capitalists will also provide assistance to their investee firms in order to protect their investment interest in these firms. Such assistance, like technical and expertise advice will be provided to these investee firms in order to ensure the firms are managed accordingly (Lingelbach, 2013).

Once the fund has been released to the investee firm, both venture capitalists and the investee firms are now subjected to the financing contract agreed (Das, Jo & Kim, 2011). Thus, if both the venture capitalists and the investee firms can unconditionally combined their economic resources together to promote their collective competencies, then the likelihood of their venture business to yield successful outcomes shall be increased. However, the management conflict between these two parties seems to be inevitable and slowly develop as differences may exist between them especially in terms of their expertise (Rosenbusch *et al.*, 2013; Gimmon *et al.*, 2011; Yitshaki, 2008; Sohaimi, 2004).

These differences may not be fully discovered during the initial evaluation stage as both parties are yet to be sealed by the venture financing contract during that time. However, once they are legally involved together in the venture cooperation, the differences may slowly be discovered and thus triggered the management conflict between them. According to Avgar (2010), Speakman and Ryals (2010), Tjosvold (2006) and Sohaimi (2004), the negative consequences of management conflict are well recognized and cited in the extant literature and the resolution is needed in mitigating the management conflict to allow both the venture capitalists and the entrepreneurs to work together in creating a successful venture business.

Investment exit or divestment is the most critical aspect of the post investment activities. Divestment will allow venture capitalists to earn their profits through disposing their investment interest in the investee firms (Annamalai & Deshmukh, 2011). Divestment is driven by a venture capitalists need to generate a profit for their capital providers and partners and this process can be achieved through two common ways, namely initial public offering (IPO) or trade sale to strategic investors (Li, Tan, Wilson & Wu, 2013). In such circumstances, buy back and write off may also be used, subject to the investees' financial condition at the time where the exit is about to begin.

According to Dai *et al.* (2012), each exit route has a different consequence for both venture capitalists and investees. Investee firms generally favor a public offering because it preserves the independence of both the firm and the entrepreneurs besides providing the firm with continued access to capital. For venture capitalists, a public offering rarely concludes their relationship with the investee firm as the underwriters may prevent venture capitalists from disposing of all shares at the time of the listing until the end of the lockup period. Dai *et al.* (2012) also said that private sales, in comparison, will almost certainly end a venture capitalists involvement with the investee firms.

Now, from the above discussions, the research model for the study as presented in figure 2.14 should be acceptable.

2.12 THE RESEARCH FRAMEWORK DEVELOPMENT

From the past research model, there is strong evidence that the controlling mechanism through the placement of a nominee director should be included as the moderator in the research framework. As past researchers have found inconclusive result on the link between the venture capitalists and entrepreneurs in their venture cooperation (Metrick & Yasuda, 2011), it is suggested that another variable called a moderator comes to moderate the relationship between the independent and dependent variables for a better explanation of their relationship (Baron & Kenny, 1987). The placement of a nominee director has the potential to moderate the relationship and also reducing the conflict level between venture capitalists and investee firms in venture cooperation shall the conflicts arise. Furthermore, there is also a need to identify whether the managerial factors identified in the literature in particular those suggested by Sohaimi (2004) fit into the study of management conflict, particularly within the context of the Malaysian venture capital environment.

The basis for the research framework looks like the following:

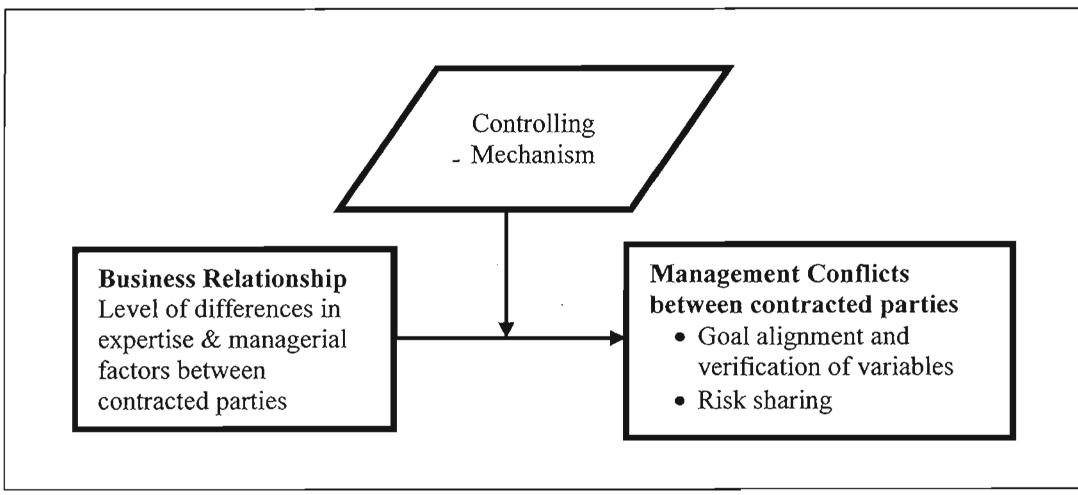


Figure 2.15
The Basis for the Research Framework of this Study (With the Inclusion of Controlling Mechanism as the Moderator)

2.13 CHAPTER SUMMARY

This chapter discusses the management conflict and the managerial factors. Besides, this chapter also has provided the overview of venture capital investment, issues arise from venture capital financing and the placement of a nominee director in venture cooperation as one of the efforts to mitigate the management conflict in venture capital financing. Based on the literatures, the moderating roles of nominee directors in venture capital financing have been grouped into three major roles, namely, Supervisory, Moderator and Problem Solving. These roles have become the foundation for the study in examining the moderating effect of nominee directors on venture relationship between the venture capitalists and their investees. Finally, this chapter discusses the past research model which has become the foundation in developing the research framework for this study.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 INTRODUCTION

Based on the problem statement, the objectives, the reviews on the related theories and past research models and the discussions on the empirical research findings from the extant literatures, the research methodology is presented in this chapter. This chapter comprises the subsections of the research framework, the research design, the research hypothesis, the data analysis techniques and finally the data analysis steps.

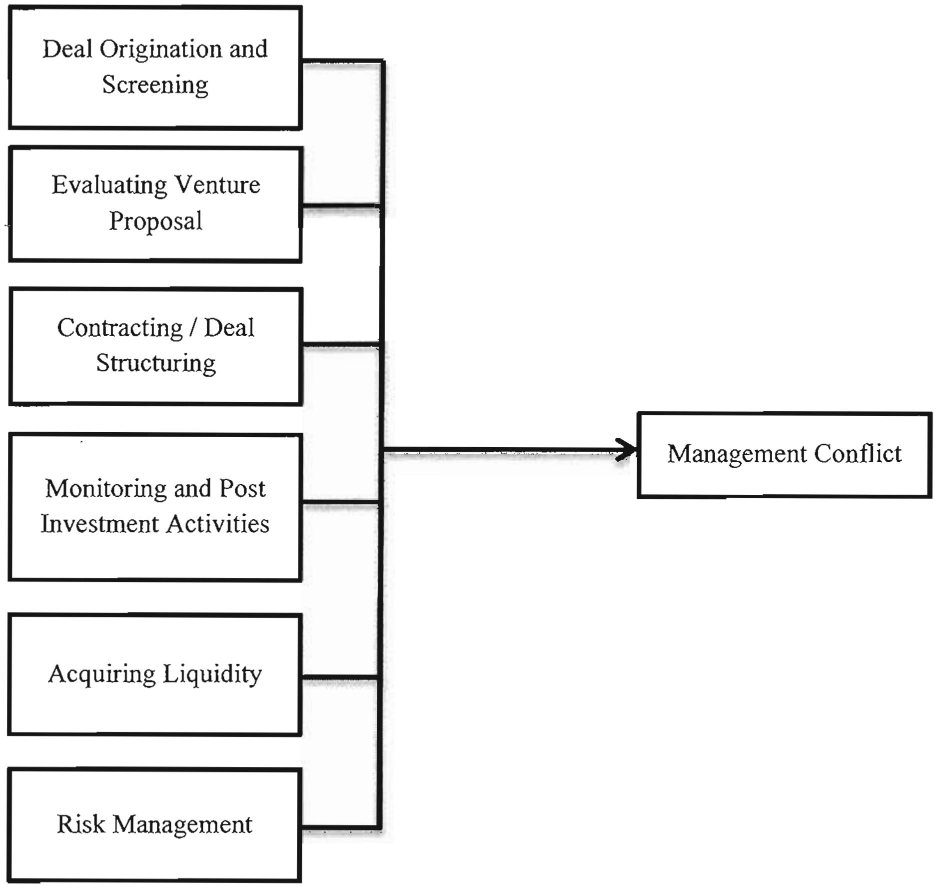
The research framework section discusses the research framework used in this study. It provides detailed discussions on the chosen framework adopted in this study. This framework becomes the study blueprint that provides guidance to the whole research process and the hypotheses development as well as the hypothesis testing.

Next is about research design, study population, data and sampling. This section discusses in details about the research design, data collection method used, data sources, study population and the sampling design. The data collection procedures are also discussed in detail in this section along with the instrumentations used for data measurement.

The discussion about the research hypotheses follows after the data and sampling section. This section discusses on the data processing procedures of the collected data. It also covers the discussion on the moderating variable roles and how it was tested as a moderator to the relationship between the independent and dependent variable. Finally, this section discusses on the data analysis techniques applied.

3.2 THE RESEARCH FRAMEWORK

The discussions on the past research model in Chapter two have become the foundation in developing the research framework for this study. Figure 3.1 shows the partial research framework focusing on the managerial factors.



Independent Variables (IVs) **Dependent Variable (DV)**

Figure 3.1
The Partial Research Framework of this Study Showing the Managerial Factors

According to Yitshaki (2008), the conflict between venture capitalists and investee firms occur in three dimensions namely contractual, contextual and procedural. The contractual conflict refers to the conflict resulted from the disagreements of venture capitalists and investees over the contractual arrangement when each party attempts to not obeying the terms agreed in the venture financing contract due to the dissatisfaction perceived by them. On the other hand, the contextual conflict occurs in the context of venture capitalists – investees firms' relationship when the investees perceived the high involvement of venture capitalists in their firms as a threat. The high involvement of venture capitalists in the investee firms may be perceived as a threat when the actions taken by venture capitalists are not in line with the investees' aspiration.

The procedural conflict refers to the relations and exchanges of information maintained between two parties engaged in interorganizational relationships. According to this dimension, conflict may occur when the parties involved in the interorganizational relationships failed to maintain the exchanges of information needed due to certain factors such as lack of trust between each other and information asymmetry.

Within the venture capital investment context, the procedural conflict may occur when the investees are perceived by the venture capitalists to be unwilling to share the information needed by them. Such conflict may bring harm not only to both venture capitalists and entrepreneurs, but it is also may shrink the opportunity of both parties to create successful venture businesses.

The third conflict dimension, which is contextual conflict, is thought to be highly related with the Sohaimi (2004) research framework and yet to be included in his study. The contextual conflict refers to the conflicts that emerge due to the dissatisfaction felt by the investees due to the controlling mechanism tools employed by the venture capitalists in the investee firms.

Generally, venture capitalists will require periodic reports from the investee firms as one of the mechanisms in monitoring their investees' business performance besides maintaining good relationship with them (Campbell II & Frye, 2009). Moreover, venture capitalists will also provide management and consulting services and marketing assistance to their investees in helping them market their products and services (Guo & Jiang, 2013). But, in most of the cases, venture capitalists as the financier will also place a nominee director in their investees' board as one of their controlling mechanism tools to maintain a good relationship with them while monitoring the investees' performance (Lau & Bruton, 2011; Campbell II & Frye, 2009).

The next figure shows the research framework focusing on its totality.

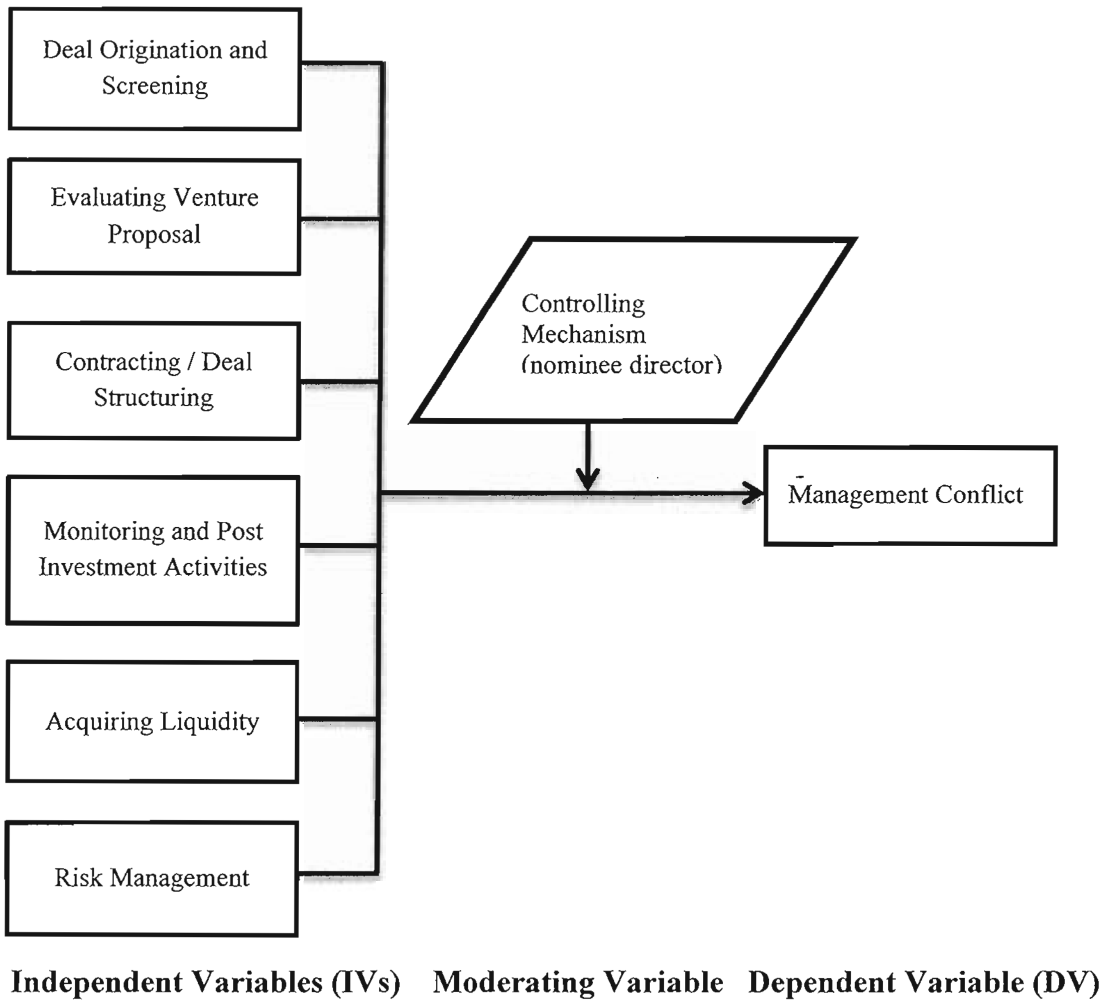


Figure 3.2
The Research Framework of this Study

The nominee director acts as a watchdog in ensuring the investee firms are always managed accordingly (Chen *et al.*, 2010). The placement of a nominee director in the investee firms is seen by many venture capitalists as one of the vital tools that have the ability to foresee and detect any problems and flaws in their investee firms' day to day business operation (Ozmel *et al.*, 2013; Campbell II & Frye, 2009). Such problems like the agency problem and investee firms' business misconduct may become major obstacles for both venture capitalists and the investee firms from creating successful venture businesses if the problems are not well addressed (Buzzacchi *et al.*, 2013; Zhang, 2012). These problems may be addressed through the placement of a nominee director in the investee firms. Hence, the placement of a nominee director in the investees' board may give venture capitalists the opportunities to closely monitoring their investees' business operation and at the same time take any necessary corrective actions to solve any problem occurred in the venture relationship (Campbell II & Frye, 2009; Salim & Yong, 2008).

However, the use of various controlling mechanisms by venture capitalists may also trigger the management conflict to occur between the venture capitalists and their investee firms. The management conflict emerges once the venture capitalists involvement in their investee firms' management reached a level in which the investee firms assumed to be unacceptable and becoming a threat to them (Gilman *et al.*, 2011; Yitshaki, 2008). Even though the venture cooperation requires the investee firms to be transparent and having full information disclosure in its operation, the tendency for the information asymmetry to occur is still exists. Certain information kept by the investee firms may still be perceived as sensitive by them as it may hold some information the investee firms considered as their trade secrets (Chen, 2010). Thus, leaving the venture capitalists with insufficient information, which may be inadequate for their monitoring, supervising and business decision making purposes.

In another situation, the investee firms' original goals may also deviate as the investees may tend to pursue their own business objectives which are different than what they have initially agreed in the venture contractual agreement with their venture capitalists (Maula *et al.*, 2009). This will also have high potential to trigger the management, conflict between the investee firms and their venture capitalists. Thus, the management conflict triggered will hinder both the venture capitalists and their investee firms from developing and successfully combining their aggregate competence in creating successful venture businesses (Alperovych & Hübner, 2011).

These are among the situations where the nominee director placed needs to play his/her role as a moderator in solving any conflict occurred between the venture capitalists and their investee firms in venture cooperation. In such circumstances, the nominee director placed will also need to use his/her own discretion in solving any conflict between the venture capitalists and their investee firms for the sake of protecting the venture capitalists' shareholder interest (Cumming & Dai, 2011).

A moderator is an independent variable that affects the strength/and or direction of the association between another independent variable and an outcome variable (Wilken, Jacob & Prime, 2013; Ro, 2012; Zakuan, Yusof, Mat Saman, Shaharoun & Laosirihongthong, 2012). A moderator is a variable that changes the relationship between the independent and dependent variable (Sekaran & Bougie, 2013). A moderator variable may 1) changes the strength of a relationship, and 2) changes the form of the relationship. Therefore, the inclusion of a controlling mechanism through the placement of a nominee director as the moderator in the research framework is assumed to have the ability to improve the relationship between the venture capitalists and their investee firms. Besides, it is also assumed to have the potential to reduce the management conflict between the venture capitalists and the investee firms in their venture cooperation. The inclusion of controlling mechanism through the placement of a nominee director in the research's framework is shown in Figure 3.2.

The above discussions are expected to provide enough evidence and justification for the use of the research framework shown in figure 3.2 to commence the data collection procedure.

3.3 THE STUDY HYPHOTHESES

The research focused on the moderating effect of a controlling mechanism through the placement of a nominee director on the venture relationship between venture capitalists and their investee firms across the complete venture capital financing cycle. According to the literature review, it can be inferred that the managerial factors (deal origination and screening, evaluating venture proposal, contracting and deal structuring, monitoring and post investment activities, acquiring liquidity and risk management) would also become one of the reasons for management conflict to occur between the venture capitalists and their investee firms in their venture cooperation. According to the arguments from the extant literature, it is also concluded that certain managerial factors may affect the management conflict experienced by the venture capitalists and their investee firms' in their venture business relationship.

For example, venture capitalists could minimize the potential of the information asymmetries that are crucial to their investment's success by thoroughly scrutinizing the prospective firms prior starting any capital investment and later on by systematically monitoring and supervising them once the investment has been made. For the investee firms, they may now start to focus on their business idea's success instead of worrying about their business financing problems. Therefore, as both venture capitalists and the investee firms are having the same meaning of reducing the management conflict in their venture business, the success of their venture business is now stands a greater prospect and also turns out to be more promising.

For that reason, the first part in this study attempt to examine the contribution of each managerial factor to the occurrence of management conflict between venture capitalists and their investees in venture cooperation across the complete venture capital financing process. This conceptual hypothesis are further categorized into the following six operational hypotheses:

H_1: There is a significant difference between deal origination and screening and management conflict.

H_2: There is a significant difference between evaluating venture proposal and management conflict.

H_3: There is a significant difference between contracting and deal structuring and management conflict.

H_4: There is a significant difference between monitoring and post investment activities and management conflict.

H_5: There is a significant difference between acquiring liquidity and management conflict.

H_6: There is a significant difference between risk management and management conflict.

The second part in this study is the investigation on the moderating effect through the placement of a nominee director on the relationships between venture capitalists and their investees across the complete venture capital financing process. Hence, the other conceptual hypothesis of this study attempt to investigate the moderating effect of placing a nominee director in the investees' board on the management conflict experienced by the venture capitalists and their investee firms across the complete venture capital financing process. For instance, the nominee director placed in the investees' board will use his/her discretion in solving any conflict between the venture capitalists and their investees throughout the venture capital investment life. This conceptual hypothesis is further categorized into the following operational hypothesis:

H_7: The controlling factor through the placement of a nominee director has a significant difference on the management conflict.

The independent variables in this research are the venture capitalists' managerial factors, namely: deal origination and screening, evaluating venture proposal, contracting and deal structuring, monitoring and post investment activities, acquiring liquidity and risk management. The dependent variable in this research is management conflict.

3.4 RESEARCH DESIGN

The study is a cross sectional study of the questionnaire survey approach with a judgment sampling method where the Malaysian venture capital companies operating in Kuala Lumpur, Penang and Selangor were selected as the targeted population of this study. The sample respondents in this study comprise of venture capital investment personnel from executive level or higher in the selected venture capital companies. The venture capital companies were identified through the Malaysian Venture Capital Development Council (MVCDC) and Malaysia Venture Capital Association (MVCA) directories obtained through their website.

3.4.1 Population of the Study

The study population comprises of both Malaysian venture capital corporations and Malaysian venture capital management corporations operating in Malaysia. According to the Malaysian Venture Capital Development Council (MVCDC), there were 113 registered venture capital companies and funds operating in Malaysia as at 31st. December 2010. Out of the 113 registered venture capital companies and funds, 102 were locally owned, 9 were joint ventures and 2 were foreign-owned venture capital management companies.

Since the focus of this research is on local venture capital companies, all foreign based venture capital firms were excluded from this study. This is to ensure that the study findings purely reflect the impact of placing a nominee director on venture cooperation within the context of Malaysian venture capital investment activities. Therefore, the population size of this study is 102 companies which comprise of both local venture capital companies and local venture capital management companies. These locally owned venture capital companies comprises of both the private and government backed venture capital companies operating in various locations in Malaysia. The address and the contact numbers for both local venture capital companies and local venture capital management companies were obtained from the MVCDC directory.

3.4.2 Unit of Analysis

The unit of analysis for this study is organization level. It included all the Malaysian venture capital corporations and venture capital management corporation operating in Malaysia. It is better to utilize them as they are the organizations involved in Malaysian venture capital industry. Thus, utilizing them gave a better understanding of the issues under investigation. Indeed, these were the most suitable organizations to provide information on the variables under investigation.

3.4.3 Sampling Technique

As to the initial understanding, census is applied in this study since the population size is relatively small. As at 31st. December 2010, there were 102 local venture capital operators registered in Malaysia. Though, only 49 respondents were operating at that moment. The remaining 53 respondents were expected to be inactive with the probability of inaccessible. These 53 respondents could not be reached as it was found that their telephone lines are no longer in service. Thus, the remaining venture capital operators were all included. As there is no specific name to be used under sampling name, judgmental sampling was used. This sampling method involves the researcher to hand-picking the sample of the research work based on his judgment about the relevance of the chosen sample to the research project (Oladele, 2007). According to Sekaran and Bougie (2013), there are two major types of purposive sampling, namely judgment sampling and quota sampling. The judgment sampling design is used when a limited number or category of people have the information that is sought. In such cases, any type of probability sampling across a cross section of the entire population is purposeless and not useful. A judgment sampling design like this is used where the collection of specialized informed inputs on the topic area researched is vital, and the use of any other sampling design would not offer opportunities to obtain the specialized information.

Apart from this sampling technique utilized to select the number of respondents, the following criteria were equally applied in selecting the final respondents who finally participated in the study:

(a) The selected venture capital companies must be incorporated in Malaysia.

(b) The selected venture capital companies must be representative and accessible.

(c) The potential respondents that are to answer the questionnaire must be in the executive position and above in the selected venture capital companies.

(d) The potential respondents that are to answer the questionnaire must perceive to have comprehensive knowledge and working experience, particularly in venture capital investment activities and venture business management.

Therefore, the decision to utilize the purposive sampling design are well justified. This is due to the sample representativeness which is vital for the generalization purposes. Besides, the selected sampling design is deemed to be the best and meaningful method to examine the task at hand.

3.5 INSTRUMENTATIONS

This research used a questionnaire survey to collect the primary data. The research questionnaire was adapted from Sohaimi (2004) who studied the management conflict between venture capitalists and their investee firms operated in the Malaysian ICT industry. A new part which comprises of the questions aims to earn information on the moderating roles played by the controlling mechanism through the placement of the nominee director in venture cooperation was provided in order to suit the questionnaire with the present study. The survey questionnaire structure is as follows. Generally, the survey questionnaire consists of twenty five (25) closed-ended and twelve (12) open-ended questions. All the close-ended questions utilized rated or ranked scales. These rated or ranked scales have several ordered response categories. All the questions in the survey questionnaire were grouped into five (5) parts.

Part 1, basic information on the respondent (venture capitalists), aims to earn basic data from the respondent. This information may be analyzed for any relationship with other variables in the study.

Part 2, the venture capitalists managerial practices and procedures, aim to earn particular information and specific opinions relating to the venture capitalists' managerial factors. Part 2 also covered five sub topics and the topics arrangement are as follows: deal origination and screening (Section A), evaluating venture proposal (Section B), contracting and venture deal structuring (Section C), monitoring and other post-investment activities (Section D), controlling mechanism (Section E) and acquiring liquidity/investment liquidation (Section F).

Part 3, venture business risk management, aims to earn particular information on the venture capitalists' managerial factors for their risk management efforts, including their perception on both the market and agency risks.

Part 4, controlling mechanism utilized by venture capitalists, aims to earn information on the moderating roles played through the placement of the nominee director in venture cooperation. Lastly, part 5, information on the venture business relationship, aims to earn particular information on management conflict faced and experienced by the venture capitalists in managing their venture business.

3.5.1 Questionnaire Descriptions

This research is conducted based on one structured survey questionnaires, targeted to the local venture capital companies operating in various economic sectors in various locations in Malaysia. Direct telephone calls to the selected respondents were made prior mailing the questionnaire to them. This had been done in order to ensure that the respondents were able to participate in the study besides confirming their valid mailing address.

The survey questionnaires had been posted to the chief executive officers and the managing directors of the selected local venture capital companies to get their answers on the designated questions focusing their managerial factors across the complete venture capital financing cycle, their risk management method utilized, the controlling mechanism they used especially regarding the placement of a nominee director and the information related to their venture business relationship. As for the questions related to the independent and dependent variables, the questions were based on the study done by Sohaimi (2004).

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3.5.2 Data Collection Procedure

Prior to the data collection process, the selected venture capital companies had been contacted through direct telephone calls. The respondents' telephone numbers were obtained directly from the Malaysian Venture Capital Development Council (MVCDC) and the Malaysia Venture Capital Association (MVCA) directories. These was to ensure that the selected venture capital companies were still active and were willing to participate in the study besides confirming their valid mailing address prior to mailing the survey questionnaire.

One letter of introduction had been attached together to accompany the survey questionnaire. The introduction letter was from the researcher's main supervisor. The introduction letter and the preface section of the survey questionnaire explained the research purposes besides asking for permission and cooperation from the respondents to allow the researcher to carry out the survey and to collect the research data and information from them. The data collection process began from January 2011 until January 2012.

3.6 DATA ANALYSIS TECHNIQUES

The primary data and other related information gathered from the survey questionnaire data were scrutinized before being analyzed using both the descriptive and SmartPLS analyses techniques. Details about these analyses are briefly discussed below.

3.6.1 Descriptive Technique

The descriptive data analysis technique was used in analyzing the respondents' non quantified data which are descriptive in nature. This analysis technique covers the mean, frequency and standard deviation. The mean, frequency and standard deviation were used to summarize the respondents' profiles, the respondents' firms' background, their investment history and investment practices. The descriptive analysis of the respondents' profiles and their firms' backgrounds were done using the SPSS software.

From the SPSS software, all details pertaining the respondents' number of employees, total managed funds, the number of investees in their investment portfolio, the number of proposals they evaluated and various other investment practices were analyzed and summarized. Besides, the respondents' opinions on the matters pertaining the placement of a nominee director in their investees as one of the controlling mechanisms to protect their investment interests were also analyzed by this technique.

3.6.2 SmartPLS

SmartPLS is a statistical software designed to help researchers mainly in social science studies to analyze their research data. This software was introduced by the Swedish statistician, Herman Wold. An alternative term for PLS is projection to latent structures, but the term partial least squares is still dominant in many areas. Although the original applications were meant to be used mainly in the social science studies, the PLS regression for instance is also used widely in most of today's research areas and disciplines. Besides, the software is also used in bioinformatics, sensometrics, neuroscience and anthropology research areas. The PLS path modeling is most often used in social sciences, econometrics, marketing and strategic management.

Partial least squares regression has been used in various disciplines such as chemistry, economics, medicine, psychology, and pharmaceutical science where predictive linear modelling, especially with a large number of predictors, is necessary. Especially in chemometrics, partial least squares regression has become a standard tool for modelling linear relations between multivariate measurements (Zhang, 2009). The SmartPLS software was utilized in this study in testing the research hypotheses and determining the relationship strength between variables used.

The study utilized the SmartPLS for different purposes in this study which are:

3.6.2.1 Loading Factor

The SmartPLS techniques were used in determining the cross loading for each item in the questionnaire. For this, a minimum loading of 0.7 and above value was required for an item to be accepted for cross loadings and composite reliability, as suggested by Hair, Ringle and Sarstedt (2011). All items which have their minimum loading of less than 0.7 were excluded from the analysis.

3.6.2.2 The Discriminant Validity

The SmartPLS Discriminant Validity of construct was used in order to test the construct validity and determining the correlation between variables used. Therefore, this technique allowed the study constructs to be validated and the correlation between the variables used to be examined.

3.6.2.3 Path Coefficient

The SmartPLS techniques were also used in determining the relationship between each independent variable with the dependent variable used in the study. The T-Statistics score was used to determine the result for each hypothesis testing, which then provides justifications for accepting and rejecting each of the study hypotheses. For this, a minimum T-Statistics score of 1.6 and above value was required for the basis of accepting or rejecting the study hypotheses.

Also, the Overall Effects analysis, which comprises of the analysis of the mean, standard deviation and T-values were used in determining whether the placement of a nominee director as a moderator has a significance difference on the management conflict between venture capitalists and their investees. The T-Statistics was used in determining the effect of the moderator used on the relationship between the independent variables and the dependent variable.

The SmartPLS techniques also were used in determining the coefficient of multiple determinations (R^2), which demonstrate the strength of the relationship between each individual variable with the dependent variable. The analysis on the R^2 is done on the individual and overall basis. For the individual analysis, the strength of the relationship between each independent variable with the dependent variable was determined using the SmartPLS R^2. For the overall analysis, the strength of the relationship between all independent variables used with the dependent variable was determined using the SmartPLS R^2. The SmartPLS R^2 was also used in comparing the relationship strength between the independent variables and a dependent variable without the moderator and with the moderator presence.

3.6.3 The Data Analysis Steps

The data analysis steps for this study are shown below:

(i) All the completed survey questionnaires retrieved from the respondents were first coded prior recording them into a databank in the Statistical Package for the Social Science (SPSS) version 19 software.

(ii) All the responses received from any open ended questions in the survey questionnaires were gathered accordingly before a clustering on the responses were done for the purpose of obtaining the most commonly grouped responses across the study variables that are being examined.

(iii) Any irregularities found in the completed survey questionnaire (for instance, non-response to particular questions) were cleaned up before the computation commence. The reliability of indicators, especially those tapped by empirical measurement, was examined. The data file in the SPSS program was then transferred to the SmartPLS program for further analysis.

(iv) The discriminant validity of construct was utilized in this study for the purpose of examining the data internal consistency prior commencing the statistical analysis.

(v) For reliability test, the SmartPLS composite reliability was used to examine the data internal reliability prior the statistical analysis. The benchmark used was 0.7 as suggested by Hair *et al.* (2011).

(vi) For the purpose of supporting the results and the study findings, the statistical analysis using the SmartPLS software was performed to provide empirical evidence and reliability. For the purpose of describing the aggregate view of the data, the descriptive statistics were employed. Specific statistical tests using the SmartPLS software were then employed for testing the research hypotheses.

3.7 CHAPTER SUMMARY

This chapter discusses the research framework and the analysis method used in this study. The study data and other related information for this study were gathered through the survey questionnaires from the selected respondents. The responses gathered were then statistically analyzed using SmartPLS software.

CHAPTER FOUR

DATA ANALYSIS AND DATA PRESENTATION

4.1 INTRODUCTION

The previous chapter detailed the methodology of the research. The preceding chapters reviewed the literature pertaining to management conflict in venture capital financing. The theory, presented in the previous chapters, is tested by investigating the relationship between the managerial factors (deal origination and screening, evaluating venture proposal, contracting and deal structuring, monitoring and post investment evaluation, acquiring liquidity and risk management) and the management conflict among Malaysian venture capital companies.

This chapter begins with the discussion on the response rate, data coding and entering and data screening and cleaning. The next section is about the data analysis result. This section discusses in details about the respondents' profile and the hypothesis testing results from the direct relationship between the independent and dependent variables. The discussion will also cover the individual direct relationship between each independent variable used with the dependent variable. This chapter also reveals the test result of the moderating effect of the nominee director on the relationship between the managerial factors and management conflict.

Finally, the discussion covers the moderating effect of controlling mechanism through the placement of a nominee director on the relationship between the stages in venture capital financing (deal origination and screening, evaluating venture proposal, contracting and deal structuring, monitoring and post investment evaluation, acquiring liquidity and risk management) and management conflict. The statistical result of the above testing results were further presented in tables and diagram accordingly.

4.2 DATA VALIDATION AND VERIFICATION

The following sections discuss the response rate, data coding and entering and data screening and cleaning of the gathered data prior the statistical analysis,. Further details are discussed below:

4.2.1 Response Rate

The population size is 102 which comprise of both locally incorporated venture capital companies and venture capital management companies registered with the Malaysian Venture Capital Development Council (MVCDC). They are operating in various locations in Kuala Lumpur, Selangor and Penang. Out of the 102 respondents that were identified, only 49 respondents were qualified to participate in the study as the study samples. The remaining 53 respondents were found to be either inactive or inaccessible. Therefore, they were not included in the study. Also, from these 49 potential respondents, only 44 respondents were willing to participate in the study. The other 5 respondents declined to participate in the study due to the reason some of them claimed to be too busy to participate in this study and as such they were left out.

With regards to the above, a total of 44 questionnaires were therefore sent out. 40 questionnaires were distributed using self-administered procedure to the venture capital chief executive officers (CEO), venture capital investment executives and venture capital investment analyst of the Malaysian venture capital firms operating in Kuala Lumpur, Selangor and Penang while the remaining 4 questionnaires were distributed via email to the remaining respondents. However, only 35 were retrieved back from the respondents.

The response rate for this study is 79.55%. According to Johnson and Owens (2003), the standard response rate recommended by the American Association for Opinion Research (AAPOR) in social science studies is 32.6%. Therefore, the response rate of 79.55% achieved in this study is considered good. All the questionnaires that were not retrieved were due to the reasons beyond the control of the researcher. The details on the response rate are presented in Table 4.1.

Table 4.1
The Response Rate on the Questionnaires

Venture Capitalists Locations	Distributed	Expected	Retained	Response Rate (%)
Kuala Lumpur	39	39	34	87.18
Selangor	4	4	1	25
Penang	1	1	0	0
Total	44	44	35	82.67

4.2.2 Data Coding and Entering

Items in the questionnaire were coded using easily identifiable codes based on the variables used once the questionnaires were retrieved. The items in the research questionnaire were grouped based on their categories and types of variables. For instance, all the descriptive type questions were grouped in one single category to separate these questions from other questions that were designed to measure the variables used.

This was succeeded by coding each of the questions based on the variables used with several letters and a particular number to recognize which variable they are measuring. For example, the first question to measure the independent variable, Deal Origination and Screening was coded with DOS1, while the questions relating to Evaluating Venture Proposal were coded with EVP. This data coding ensures that the questionnaires are easily referred to and at the same time may prevent the researcher from making mistakes while keying in the data into the computer. Upon completion of the above process, all the retrieved questionnaires were now ready for the data entering process and were then entered accordingly by the researcher into the Statistical Package for Social Sciences (SPSS) software version 19.

4.2.3 Data Screening and Cleaning

Data screening and cleaning involves checking for error in the data collected (Pallant, 2007). These errors may be in the form of missing data or outliers (values that fall outside the range of possible values for a vehicle). Therefore, using the

SPSS, the study conducted an error checking on the keyed in data by plotting the minimum and maximum number for all variables used. This will allow the missing and outliers to be detected. However, an inspection of the output result of the analysis indicates that the data is free from errors such as missing data or out of range data. Therefore, this has given the data a clearance for further analysis.

4.2.4 Basic Assumptions for Statistical Analysis

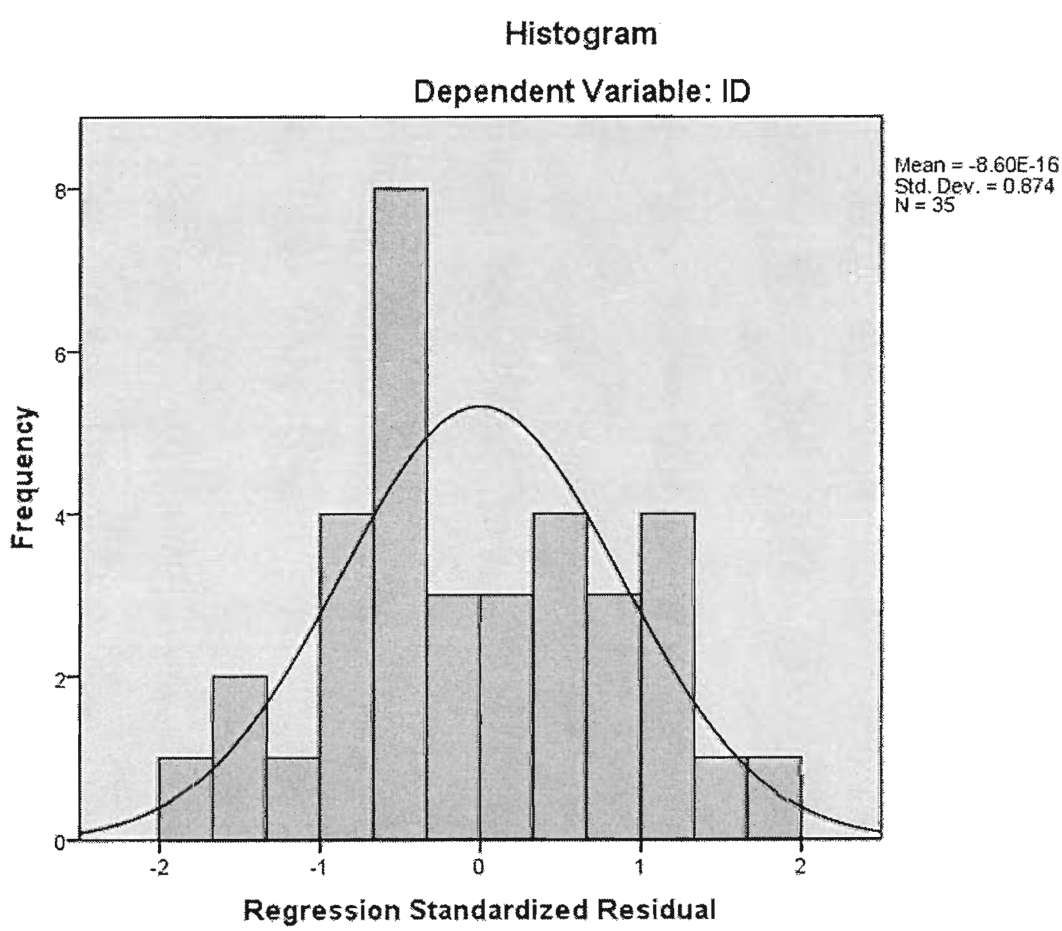
Based on the theory and practice, some analysis, such as regression and correlation make a number of assumptions such as outliers, normality, linearity and homoscedasticity. They are more or less a pre-requisite for the application of regression analysis in any study (Pallant, 2007). In this view, a number of assumptions such as outliers and normality were performed in this study.

4.2.4.1 Treatment of Outliers

This was performed using the histogram as recommended by Pallant (2007). The initial checking and inspection of the data using this method indicates that there were no outliers. Therefore, the data is free from any outliers case. Hence, this basic assumption is met.

4.2.4.2 Test of Normality

This assumption was performed to check the normality of the study data. The output result as indicated by the histogram and depicted in Figure 4.1 shows that the data scores were not normally distributed. This is attributed to the small sample size. According to Pallant (2007), the sample size has a significant impact on the normalization of data for any study. The propensity of the study data to normalize will be increased if the sample size is increased. Hence, the larger the data the normal the data becomes. However, the size of the sample for this study could not be increased due to the small population size. Hence, the present normality of the data set in this study.



Normal P-P Plot of Regression Standardized Residual

Dependent Variable: ID

Figure 4.1
Normal Tabulation from the Test of Normality

4.3 DESCRIPTIVE ANALYSIS

The study used two data analysis techniques in analyzing the data gathered. The two data analysis techniques used are descriptive technique and SmartPLS. The discussions on the descriptive analysis techniques and its findings are presented in the following section.

4.3.1 Descriptive Technique

The descriptive data analysis technique was used in analyzing the respondents' non quantified data which are descriptive in nature. This analysis technique covers the descriptive analysis of the respondents' profile, the respondents' firms' background, investment history and investment practices as well. Apart from that, the respondents' opinions on the matters pertaining the placement of a nominee director in their investees as one of the controlling mechanisms to protect their investment interests were also analyzed by this technique.

4.3.2 Descriptive Analysis Result

The descriptive analysis was conducted using the SPSS version 19. It was conducted in order to summarize the particulars of the respondents. The results of the descriptive analysis are shown in Table 4.2.

4.3.2.1 Respondents' Profile

The output from the descriptive analysis indicates that 25 respondents (71.4%) were from venture capital firms which have been in operation in between 6 – 10 years, while the other 10 respondents (28.6%) were from young venture capital firms which have been in operation for the last 5 years. 29 respondents (82.86 %) were attached to venture capital firms which operates with less than 10 employees while another 6 respondents (17.14%) were attached with venture capital firms with more than 10 employees.

From here, 18 respondents (51.43%) reported that their firms have 5 or less venture capital executives, 15 respondents (42.86%) were from firms which have in between 6 to 10 venture capital executives and the other 2 respondents (5.7%) were from firms which have more than 10 venture capital executives.

The majority of the respondents or 22 of them (62.9%) reported that their venture capital firms have total funds of up to RM250 millions. 4 respondents (11.4%) reported that their firms have funds less than RM30 millions, whereas the remaining 9 respondents (25.7%) were from firms which have funds of more than RM250 millions. Most of the funds have been invested when 22 of the respondents (62.9%) said their firms have invested between RM30 millions to RM250 millions in their investees.

However, there are still vast venture capital funds available for investment when 21 of the respondents (60%) reported that their firms still have in between RM30 millions to RM250 millions available funds for investments. On the other hand, 13 respondents (37.1%) reported that there were less than RM30 million funds available in their firms for investments.

The majority of the respondents or 16 of them (45.7%) received in between 101 to 150 investment proposals within a year. While 13 respondents (37.1%) received in between 1 to 100 proposals within a year and the remaining 6 respondents (17.1%) received more than 150 investment proposals a year. Out of this, 19 respondents (54.3%) reviewed between 1 to 100 proposals received, 13 respondents (37.1%) reviewed between 101 to 150 proposals received and the remaining 3 respondents (8.6%) reviewed more than 150 proposals submitted to them within a year.

From hundreds of proposals submitted, only a few will be shortlisted for funding. 31 respondents (88.6%) reported that their firms have funded in between 0 to 5 firms only from the total business proposals received. 3 respondents (8.6%) have lead their firms to fund more than 10 firms, while the other 1 respondent (2.9%) has led his/her firm to fund in between 6 to 10 firms from the total investment proposals received.

Seventeen respondents (48.6%) reported that their firms only have in between 0 to 5 investee firms. Nine respondents (25.7%) reported that their firms have 6 to 10 investees while the remaining 9 respondents (25.7%) reported that their firms have more than 10 investees. The minimum percentage of equity stake per investment that the respondents were willing to accept being in between 1% to 10% (97.1%) and in between 11% to 30% (2.9%). Whereas, the maximum percentage of equity stake per investment that the respondents were willing to accept is in between 11% to 30% (60%) and more than 30% (40%).

The result also found that all the respondents (100%) prefer to use the referral process in their deal origination. 27 respondents (77.1%) prefer cold calls while the remaining 8 respondents (22.9%) prefer active search. From the perspective of the investment period, 25 respondents (71.4%) planned to have 3 to 5 years of investment duration. The other 10 respondents (28.6%) planned to have in between 0 to 2 years for their investment duration. The acceptable investment duration for the respondents is in between 3 to 5 years (85.7%) and more than 5 years (14.3%).

On the other hand, the acceptable rate of return for the respondents is in between 1% to 20% (34.3%) and 21% to 40% (65.7%). Out of this, 22 respondents (62.9%) were willing to reconsider the investment proposal if the venture rate of return is lower than what they expected. Most of the respondents that were willing to reconsider the lower return venture proposal will either temporarily adjust the rate of return (22.9%) or left the rate of return unadjusted (40%).

Nineteen respondents (54.3%) spent less than 3 months to evaluate the venture proposal and another 16 respondents (45.7%) spent between 3 to 6 months for the venture evaluation. All respondents (100%) agreed that the investment form and terms, call and put option, go-along rights, pre-emptive rights, information rights and board structure are the provisions that need to be included in the funding contract. The other provisions to be included in the funding contract are the registration rights (68.6%) and option pool/buy back provision (88.6%).

26 of the respondents (74.3%) reported that they prefer to invest in medium risk type ventures. 9 other respondents (25.7%) prefer to invest in high risk type ventures. None of the respondents wanted to invest in low risk type ventures.

Twenty eight respondents (80%) prefer their venture capital firms to have both specific contractual monitoring and non-contractual monitoring methods simultaneously in monitoring their investees. There were only 7 respondents (20%) that prefers their firms to use only non-contractual monitoring method. None of the respondents agreed to use specific contractual monitoring method solely in monitoring their investees.

In terms of maintaining a good venture relationship between venture capitalists and their investees, the respondents agreed to place a nominee director on their investee firms' board (85.7%), providing management consulting service (74.3%), providing marketing assistance (60%), having a personal relationship with the investees (82.9%) and require periodic reports from the investees (100%). Only 1 respondent (2.9%) reported that they will limit their involvement to the provision of capital only in their investees as one of the methods used in maintaining good relationship with their investees.

The study shows that 25 of the respondents surveyed (71.4%) wanted to place a nominee director on their investees' board. Even though not all of the respondents wanted to place a nominee director on their investees' board, all of them (100%) agreed that the nominee director should act in the best interest of their venture capital firms or financiers instead of their investees. Majority of the respondents or 24 of them (68.6%) reported that they often have problems with their investees. Six respondents (17.1%) reported they sometimes had problems with their investees and the other 5 respondents (14.3%) reported they rarely have any problems with their investees.

Table 4.2
Descriptive Analysis of the Respondents' Background and Investment Practice

N	Frequency	Percentage	Mean	Standard Deviation
Number of years in operation:				
0 – 5 years	10	28.6%	1.71	.458
6 – 10 years	25	71.4%		
Number of employees				
Total employees:				
1 – 10 employees	29	82.9%	1.17	.382
11 – 30 employees	6	17.1%	1.54	.611
Total VCs Executives:				
1 – 5 executives	18	51.4%	1.54	.611
6 – 10 executives	15	42.9%		
> 10 executives	2	5.7%		
Total funds.				
Managed:				
RM0 – RM30,000,000	4	11.4%		
RM30,000,001 – RM250,000,000	22	62.9%	2.14	.601
> RM250,000,000	9	25.7%		
Invested:				
RM0 – RM30,000,000	10	28.6%		
RM30,000,001 – RM250,000,000	22	62.9%	1.8	.584
> RM250,000,000	3	8.6%		
Available:				
RM0 – RM30,000,000	13	37.1%	1.66	.539
RM30,000,001 – RM250,000,000	21	60.0%		
> RM250,000,000	1	2.9%		

Table 4.2 (Continued)

Number of proposals.				
Received:				
1 – 100 proposals	13	37.1%		
101 – 150 proposals	16	45.7%	1.8	.719
> 150 proposals	6	17.1%		
Reviewed:				
1 – 100 proposals	19	54.3%		
101 – 150 proposals	13	37.1%	1.54	.657
> 150 proposals	3	8.6%		
Invested:				
0 – 5 firms	31	88.6%		
6 – 10 firms	1	2.9%	1.20	.584
> 10 firms	3	8.6%		
Number of investees:				
0 – 5 firms	17	48.6%		
6 – 10 firms	9	25.7%	1.77	.843
> 10 firms	9	25.7%		
Equity stake percentage for each investment made.				
Minimum:				
1% - 10%	34	97.1%	1.03	.169
11% - 30%	1	2.9%		
Maximum:				
11% - 30%	21	60%	2.4	.497
> 30%	14	40%		
Deal origination and Screening				
Active search for deals:				
Yes	30	85.7%	1.14	.355
No	5	14.3%		
Cold calls:				
Yes	27	77.1%	1.23	.426
No	8	22.9%		
Referral process:				
Yes	35	100%	1.00	.000
No				
Investment planning period:				
0 -2 years	10	28.6%	1.71	.458
3 – 5 years	25	71.4%		
Acceptable investment duration:				
3 -5 years	30	85.7%	2.14	.355
> 5 years	5	14.3%		

Table 4.2 (Continued)

Acceptable Return on Investment:				
1% - 20%	12	34.3%	1.66	.482
21% - 40%	23	65.7%		
Reconsider venture proposal with lower return:				
Yes	22	62.9%	1.37	.490
No	13	37.1%		
VCs who reconsider will:				
Adjust the ROI temporarily	8	22.9%	2.27	.985
Adjust the ROI permanently	0	0%		
ROI is left unadjusted	14	40%		
Investment planning period:				
0 -2 years	10	28.6%	1.71	.458
3 – 5 years	25	71.4%		
Acceptable investment duration:				
3 -5 years	30	85.7%	2.14	.355
> 5 years	5	14.3%		
Acceptable Return on Investment:				
1% - 20%	12	34.3%	1.66	.482
21% - 40%	23	65.7%		
Reconsider venture proposal with lower return:				
Yes	22	62.9%	1.37	.490
No	13	37.1%		
VCs who reconsider will:				
Adjust the ROI temporarily	8	22.9%	2.27	.985
Adjust the ROI permanently	0	0%		
ROI is left unadjusted	14	40%		
The investment evaluation time:				
Less than 3 months	19	54.3%	1.46	.505
From 3 to 6 months	16	45.7%		
From 6 to 9 months	0			
From 9 months to 1 year	0			
More than 1 year	0			

Table 4.2 (Continued)

Provisions included in the contract:				
Form and terms of investment				
Yes	35	100%	1.00	.000
No	0	0%		
Puts and call option				
Yes	35	100%	1.00	.000
No	0	0%		
Registration rights				
Yes	24	68.6%	1.31	.471
No	11	31.4%		
Go-along rights				
Yes	35	100%	1.00	.000
No	0	0%		
Pre-emptive rights				
Yes	35	100%	1.00	.000
No	0	0%		
Information rights				
Yes	35	100%	1.00	.000
No	0	0%		
Option pool, buy back provision				
Yes	31	88.6%	1.11	.323
No	4	11.4%		
Board structure				
Yes	35	100%	1.00	.000
No	0			
Preferred monitoring method:				
Specific contractual monitoring	0	0%	2.80	.406
Non-contractual monitoring	7	20%		
Both methods	28	80%		

Table 4.2 (Continued)

Method of maintaining relationship				
Placing a nominee director:				
Yes	30	85.7%	1.14	.355
No	5	14.3%		
Management consulting service:				
Yes	26	74.3%	1.26	.443
No	9	25.7%		
Marketing assistance:				
Yes	21	60%	1.4	.497
No	14	40%		
Personal relationships with investee:				
Yes	29	82.9%	1.17	.382
No	6	17.1%		
Require periodic reports:				
Yes	35	100%	1.00	.000
No	0	0		
Limit involvement to provision of capital only:				
Yes	1	2.9%	1.97	.169
No	34	97.1%		
The need for a nominee director:				
Compulsory	25	71.4%	1.4	.695
Not compulsory	6	17.1%		
Depends on the investment amount	4	11.4%		
For 'compulsory' answer, the nominee director should have:				
High degree of involvement	17	48.6%	1.44	.712
Moderate degree of involvement	5	14.3%		
Low degree of involvement	3	8.6%		

Table 4.2 (Continued)

How should the nominee director dealing with conflict:				
Best interest of the financier (VCs)	35	100%	1.00	.000
Best interest of the investees.	0	0%		
Nominee director should be neutral	0	0%		
Type of venture VCs prefers most:				
High risk	9	25.7%	1.74	.443
Medium risk	26	74.3%		
Low risk	0	0%		
The frequency of problems with the investees:				
Never	0	0%		
Rare	5	14.3%	3.54	.741
Sometimes	6	17.1%		
Often	24	68.6%		

4.4 ANALYSIS OF DATA

The following sections discuss the analysis results on the data using the SmartPLS software. This section covers a brief introduction to the SmartPLS analysis techniques. Then, the analysis discusses the factor analysis, followed by the hypotheses testing results of the direct relationship between the independent variables (deal origination and screening, evaluating venture proposal, contracting and deal structuring, monitoring and post investment activities, acquiring liquidity and risk management) and the dependent variable (management conflict). Finally, this section discusses the moderating effect of control mechanism on the relationship between the independent variables and a dependent variable. The statistical testing results of the above analysis are presented in the tables and figures accordingly.

4.4.1 SmartPLS

SmartPLS is a statistical software designed to help researchers mainly in social science studies to analyze their research data. This software was introduced by the Swedish statistician, Herman Wold. An alternative term for PLS is projection to latent structures, but the term partial least squares is still dominant in many areas. Although the original applications were meant to be used mainly in the social science studies, the PLS regression for instance is also used widely in most of today's research areas and disciplines. Besides, the software is also used in bioinformatics, sensometrics, neuroscience and anthropology research areas. The PLS path modeling is most often used in social sciences, econometrics, marketing and strategic management.

PLS is an extension of the multiple linear regression models. It specifies a linear relationship between a dependent (response) variable *Y*, and a set of predictor variables, the *X*'s. For many data analysis problems, estimates of the linear relationships between variables are adequate to describe the observed data, and to make reasonable predictions for new observations.

Partial least squares regression extends multiple linear regression without imposing the restrictions employed by discriminant analysis, principal components regression, and canonical correlation. In partial least squares regression, prediction functions are represented by factors extracted from the Y'XX'Y matrix. The number of such prediction functions that can be extracted typically will exceed the maximum of the number of Y and X variables.

In short, partial least squares regression is probably the least restrictive of the various multivariate extensions of the multiple linear regression models. This flexibility allows it to be used in situations where the use of traditional multivariate methods is severely limited, such as when there are fewer observations than predictor variables. Furthermore, partial least squares regression can be used as an exploratory analysis tool to select suitable predictor variables and to identify outliers before the classical linear regression.

Partial least squares regression has been used in various disciplines such as chemistry, economics, medicine, psychology, and pharmaceutical science where predictive linear modelling, especially with a large number of predictors, is necessary. Especially in chemometrics, partial least squares regression has become a standard tool for modelling linear relations between multivariate measurements (Zhang, 2009).

4.4.2 Factor Analysis

Factor analysis has been performed in order to check for the construct validity of the items as well as to see whether each item in the research framework was able to measure what they intend to measure. Therefore, a validity test has been performed using the Partial Least Squares (PLS) software, SmartPLS. Consequently, all the respondents' responses that were keyed into the SPSS software before were then transferred to the SmartPLS software for factor analysis in testing the model fitness and construct validity. The results are presented in Table 4.3.

4.4.3 PLS Estimation Results With SmartPLS

Due to the insufficient and small population size, explanation on endogenous construct, variance-based methods and the violation of the basic assumptions, the use of Partial Least Square (PLS) becomes necessary in this study in analyzing the data (Zhang, 2009). Sharma and Kim (2012) noted that the use of PLS becomes necessary under conditions of insufficient sample size while Chin (1998) concurred that PLS is required for data analysis in situations where there are many indicators and factors involved. In this vain, Zhang (2009) noted that PLS can deal with both formative and reflective construct, which is the exact situation in this study.

Furthermore, according to Tabachnick and Fidell (2012), the number of study samples needs to be at least 50 in order to allow the regression analysis to be performed using SPSS program. However, there are only 35 samples in this study. Therefore, the use of the SPSS program to analyze the study data is not possible in this study. Thus, these situations reflect the present study and therefore, the study has opted for the use of PLS for the data analysis.

4.4.4 Measurement Model

For the model measurement, construct validity was conducted using the smartPLS with a two-step structural equation modeling (SEM) approach by Anderson and Gerbing (1988). Based on this, the internal reliability and convergent validity for constructs were first conducted and then followed by the assessment of the discriminant validity of constructs as indicated in Table 4.3. For this, a minimum loading of 0.7 and above value was required for an item to be accepted for cross loadings and composite reliability as suggested by Hair *et al.* (2011).

The result in Table 4.3 as well as Figure 4.2 indicates that only 2 items coded as DOSc and DOSf were retained for Deal Origination and Screening. 5 items coded EVP2a, EVP3ETb, EVP3MAa, EVP3PDa and EVP3PDc were also retained for Evaluating Venture Proposal. 2 items coded as CDSc and CDSd were retained for Contracting and Deal Structuring, while 2 items coded as MPI1a and MPI1e were retained for Monitoring and Post Investment activities. 5 items coded as RM1b, RM2ARc, RM2ARd, RM2MRd and RM2MRg were retained for Risk Management. 4 items coded as CM1c, CM1i, CM2c and CM3d were retained for Controlling Mechanism. 6 items coded as IAR2b, IAR2c, IAR2d, IAR2e, IAR2f and IAR2g were also retained for Management Conflict. One of the independent variables, Acquiring Liquidity and other items were removed due to the low loadings of less than 0.70. The loadings and cross loadings for the analyzed data are presented in Table 4.4 and Figure 4.2 respectively.

For the average variance extracted (AVE), a minimum value of 0.5 is considered accepted (Gefen, Straub & Boudreau, 2000; Chin, 1998; Bagozzi, Youjae & Phillips, 1991; Fornell & Larcker, 1981). The discriminant validity of constructs is determined by the average variance shared between each construct and its measures should exceed the variance shared between the construct and other constructs (Fornell & Larcker, 1981). Table 4.3 further indicates that all construct utilized in the study produced AVE values more than the suggested value of 0.5 by Chin (1998) and Bagozzi *et al.* (1991).

Accordingly, the result also indicates that all construct yield factor loaded more than 0.7 as suggested by (Hair *et al.*, 2011) while the values for composite reliability also indicated 0.7 and above as suggested (Gefen *et al.*, 2000; Bagozzi *et al.*, 1991), suggesting that the measurement model has achieved satisfactory internal reliability and convergent validity.

Table 4.3
Measurement Model Result

Latent variables	**Items**	**Loadings**	**AVE**	**Composite Reliability**
CDS	CDSc	0.873491	0.801094	0.889508
	CDSd	0.916080		
CM	CM1c	0.902932	0.740608	0.777634
	CM1i	0.958777		
	CM2c	0.804822		
	CM3d	-0.761679		
DOS	DOSc	0.795995	0.591064	0.742732
	DOSf	0.740621		
EVP	EVP2a	-0.870927	0.674948	0.355035
	EVP3ETb	0.807604		
	EVP3MAa	-0.704151		
	EVP3PDa	0.871007		
	EVP3PDc	0.842331		
MC	IAR2b	0.706685	0.585676	0.894211
	IAR2c	0.773541		
	IAR2d	0.704601		
	IAR2e	0.777776		
	IAR2f	0.796354		
	IAR2g	0.825051		
MPI	MPI1a	0.8167	0.752971	0.858683
	MPI1e	0.915915		
RM	RM1b	0.813775	0.701401	0.242900
	RM2Arc	0.865786		
	RM2ARd	0.879343		
	RM2MRd	0.857290		
	RM2MRg	0.766160		

Note: Composite Reliability (CR) = (square of the summation of the factor loadings)/[(square of the summation of the factor loadings) + (square of the summation of the error variances)]; [b]Average Variance Extracted (AVE) = (summation of the square of the factor loadings)/[(summation of the square of the factor loadings) + (summation of the error variances)].

Table 4.4
Loadings and Cross Loadings

	CDS	CM	DOS	EVP	MC	MPI	RM
CDSc	0.873491	0.355741	0.102011	0.318360	0.403999	0.297686	0.071828
CDSd	0.916080	0.522461	0.040856	0.469023	0.502423	0.398858	0.168806
CM1c	0.221970	0.902932	0.684579	0.768528	0.819630	0.913842	0.391445
CM1i	0.514375	0.958777	0.470480	0.914586	0.797240	0.823261	0.482369
CM2c	0.629593	0.804822	0.308399	0.743133	0.675541	0.617392	0.500845
CM3d	-0.38160	-0.76167	-0.46534	-0.57724	-0.63947	-0.69168	-0.10544
DOSc	-0.19953	0.426786	0.795995	0.238452	0.516869	0.432405	0.756175
DOSf	0.345509	0.449065	0.740621	0.400699	0.456567	0.520080	-0.00042
EVP2a	-0.48730	-0.73642	-0.32776	-0.87092	-0.64707	-0.71602	-0.19841
EVP3ETb	0.423754	0.720160	0.216954	0.807604	0.425784	0.484703	0.508142
EVP3MAa	-0.32429	-0.56002	-0.26353	-0.70415	-0.43951	-0.54392	-0.02998
EVP3PDa	0.417805	0.796907	0.256993	0.871007	0.552165	0.570585	0.484771
EVP3PDc	0.204195	0.777913	0.554263	0.842331	0.641103	0.823553	0.204306
IAR2b	0.708467	0.636399	0.387396	0.530344	0.706685	0.537115	0.617112
IAR2c	0.171967	0.606577	0.629399	0.411720	0.773541	0.740185	0.339767
IAR2d	0.462788	0.540959	0.389499	0.431662	0.704601	0.506957	0.401595
IAR2e	0.308709	0.793680	0.585206	0.677384	0.777776	0.796422	0.391112
IAR2f	0.460083	0.617043	0.355979	0.478352	0.796354	0.594603	0.217531
IAR2g	0.279180	0.698849	0.517637	0.531514	0.825051	0.742133	0.222512
MPI1a	0.296131	0.662239	0.443913	0.706576	0.601647	0.816726	0.122011
MPI1e	0.378398	0.864379	0.604968	0.669772	0.865853	0.915915	0.377211
RM1b	0.038851	0.488172	0.463248	0.349026	0.449420	0.395519	0.813775
RM2ARc	-0.11746	-0.36486	-0.48502	-0.31501	-0.49657	-0.34663	-0.86578
RM2ARd	-0.16359	-0.21772	-0.37537	-0.18223	-0.29642	-0.05409	-0.87934
RM2MRd	-0.18806	0.254417	0.532415	0.133767	0.261845	0.134745	0.857290
RM2MRg	0.364772	0.411714	0.301853	0.341227	0.383916	0.237886	0.766160
CDSc	0.873491	0.355741	0.102011	0.318360	0.403999	0.297686	0.071828
CDSd	0.916080	0.522461	0.040856	0.469023	0.502423	0.398858	0.168806
CM1c	0.221970	0.902932	0.684579	0.768528	0.819630	0.913842	0.391445
CM1i	0.514375	0.958777	0.470480	0.914586	0.797240	0.823261	0.482369
CM2c	0.629593	0.804822	0.308399	0.743133	0.675541	0.617392	0.500845
CM3d	-0.38160	-0.76167	-0.46534	-0.57724	-0.63947	-0.69168	-0.10544
DOSc	-0.19953	0.426786	0.795995	0.238452	0.516869	0.432405	0.756175
DOSf	0.345509	0.449065	0.740621	0.400699	0.456567	0.520080	-0.00042
EVP2a	-0.48730	-0.73642	-0.32776	-0.87092	-0.64707	-0.71602	-0.19841
EVP3ETb	0.423754	0.720160	0.216954	0.807604	0.425784	0.484703	0.508142
EVP3MAa	-0.32429	-0.56002	-0.26353	-0.70415	-0.43951	-0.54392	-0.02998
EVP3PDa	0.417805	0.796907	0.256993	0.871007	0.552165	0.570585	0.484771
EVP3PDc	0.204195	0.777913	0.554263	0.842331	0.641103	0.823553	0.204306
IAR2b	0.708467	0.636399	0.387396	0.530344	0.706685	0.537115	0.617112
IAR2c	0.171967	0.606577	0.629399	0.411720	0.773541	0.740185	0.339767
IAR2d	0.462788	0.540959	0.389499	0.431662	0.704601	0.506957	0.401595
IAR2e	0.308709	0.793680	0.585206	0.677384	0.777776	0.796422	0.391112
IAR2f	0.460083	0.617043	0.355979	0.478352	0.796354	0.594603	0.217531
IAR2g	0.279180	0.698849	0.517637	0.531514	0.825051	0.742133	0.222512
MPI1a	0.296131	0.662239	0.443913	0.706576	0.601647	0.816726	0.122011
MPI1e	0.378398	0.864379	0.604968	0.669772	0.865853	0.915915	0.377211
RM1b	0.038851	0.488172	0.463248	0.349026	0.449420	0.395519	0.813775
RM2ARc	-0.11746	-0.36486	-0.48502	-0.31501	-0.49657	-0.34663	-0.86578
RM2ARd	-0.16359	-0.21772	-0.37537	-0.18223	-0.29642	-0.05409	-0.87934
RM2MRd	-0.18806	0.254417	0.532415	0.133767	0.261845	0.134745	0.857290
RM2MRg	0.364772	0.411714	0.301853	0.341227	0.383916	0.237886	0.766160

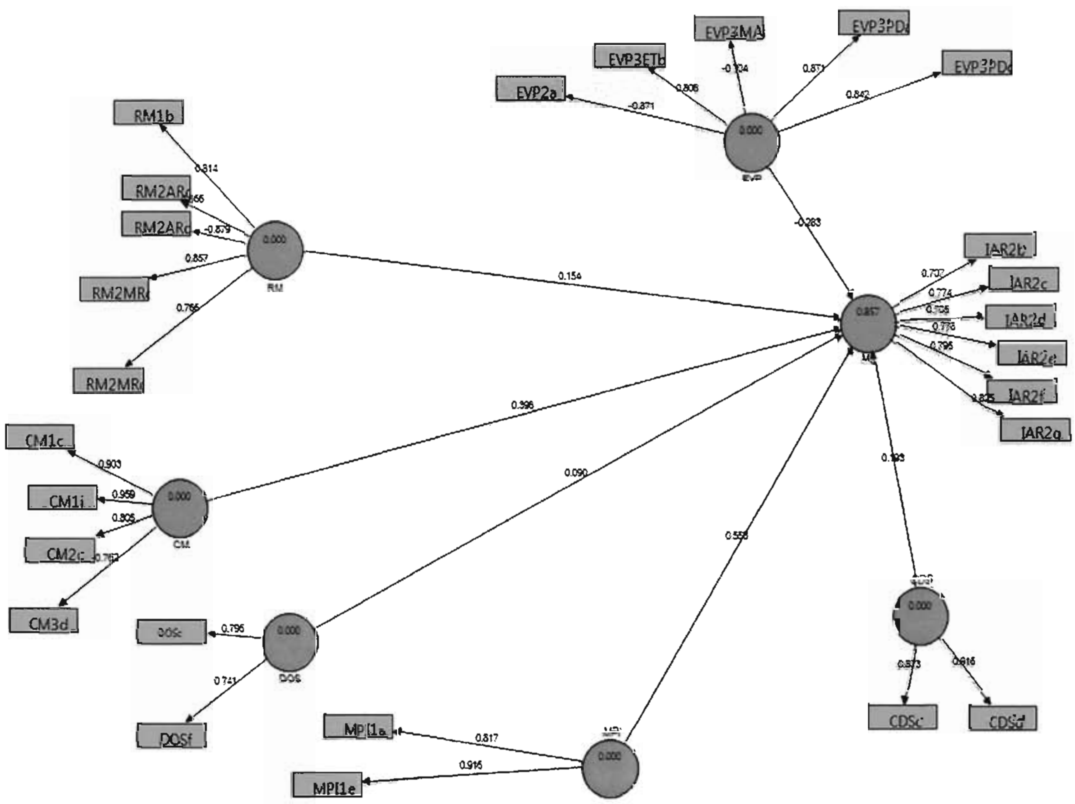


Figure 4.2
Variables Loadings

Table 4.5 shows the result of the discriminant validity for all the theoretical constructs. It indicates that the correlation for each construct is less than the square root of the average variance extracted. This suggests that the measurement model has achieved adequate discriminant validity (Hair *et al.*, 2011; Fornell & Larcker, 1981). To achieve this, we first conducted a component factor analysis to determine and identify which dimension an item belongs to. In other words, the analysis was used to structure the measurement item according to the dimension they measured. Then, we determined the discriminant validity of the dimensional constructs and the result indicates that the correlation for each dimensional construct is less than the square root of the average variance extracted suggesting that the measurement model has achieved adequate discriminant validity (Hair *et al.,* 2011; Fornell & Larcker 1981).

Table 4.5
Discriminant Validity of Constructs

Latent Variables	1	2	3	4	5	6	7
CDS	**0.895039**						
CM	0.498594	**0.860586**					
DOS	0.076353	0.568163	**0.768807**				
EVP	0.447095	0.859494	0.409669	**0.821552**			
MC	0.510645	0.856755	0.634348	0.674287	**0.76529**		
MPI	0.393784	0.842862	0.615725	0.782508	0.565454	**0.86774**	
RM	0.139383	0.437594	0.516538	0.338696	0.477198	0.311371	**0.837497**

Note: Diagonals (bolded) represent the square root of the average variance extracted while the other entries represent the correlations.

4.4.5 Hypotheses Testing Results for the Direct Relationship

The result of the SmartPLS structural model presented in Table 4.6 depicts the relationship between the exogenous and the endogenous constructs. It shows that there is a significant relationship between Contracting and Deal Structuring (CDS) and the management conflict (ß = 0:193005; t-Statistics = 1.694172). The result also shows that there is also a significant relationship between Controlling Mechanism (CM) and the management conflict (ß = 0.398033; t-Statistics = 2.0). Further analysis also found that there is a significant relationship between Evaluating Venture Proposal (EVP) and management conflict (ß = -0.2833; t-Statistics = 1.60). The Monitoring and Post Investment (MPI) activities is also found to have a significant relationship with the management conflict (ß = 0.552515; t-Statistics = 3.160644).

However, the result indicates that there is no significant relationship between Deal Origination and Screening (DOS) with the management conflict (ß = 0.090018; t-Statistics = 0.846437). Further analysis also found that there is no significant relationship between Risk Management (RM) and management conflict (ß = 0.153538; t-Statistics = 1.183482). The overall R^2 is found to be 0.857095, which implies that the exogenous variables; deal origination and screening, evaluating venture proposal, contracting and deal structuring, monitoring and post investment activities, risk management and controlling mechanism explain 85.7% variance of the endogenous construct – management conflict.

Table 4.6
Path Coefficients and Hypotheses Testing for the Direct Effects

Hypotheses	Relationship	Beta	Standard Error	t - Statistics	Decision
H_1	DOS -> MC	0.090018	0.106349	0.846437	**Not supported**
H_2	EVP -> MC	-0.283300	0.178968	1.582961	**Supported**
H_3	CDS -> MC	0.193005	0.113923	1.694172	**Supported**
H_4	MPI -> MC	0.552515	0.174811	3.160644	**Supported**
H_6	RM -> MC	0.153538	0.129734	1.183482	**Not Supported**
H_7	CM -> MC	0.398033	0.198407	2.006149	**Supported**

P<0.10

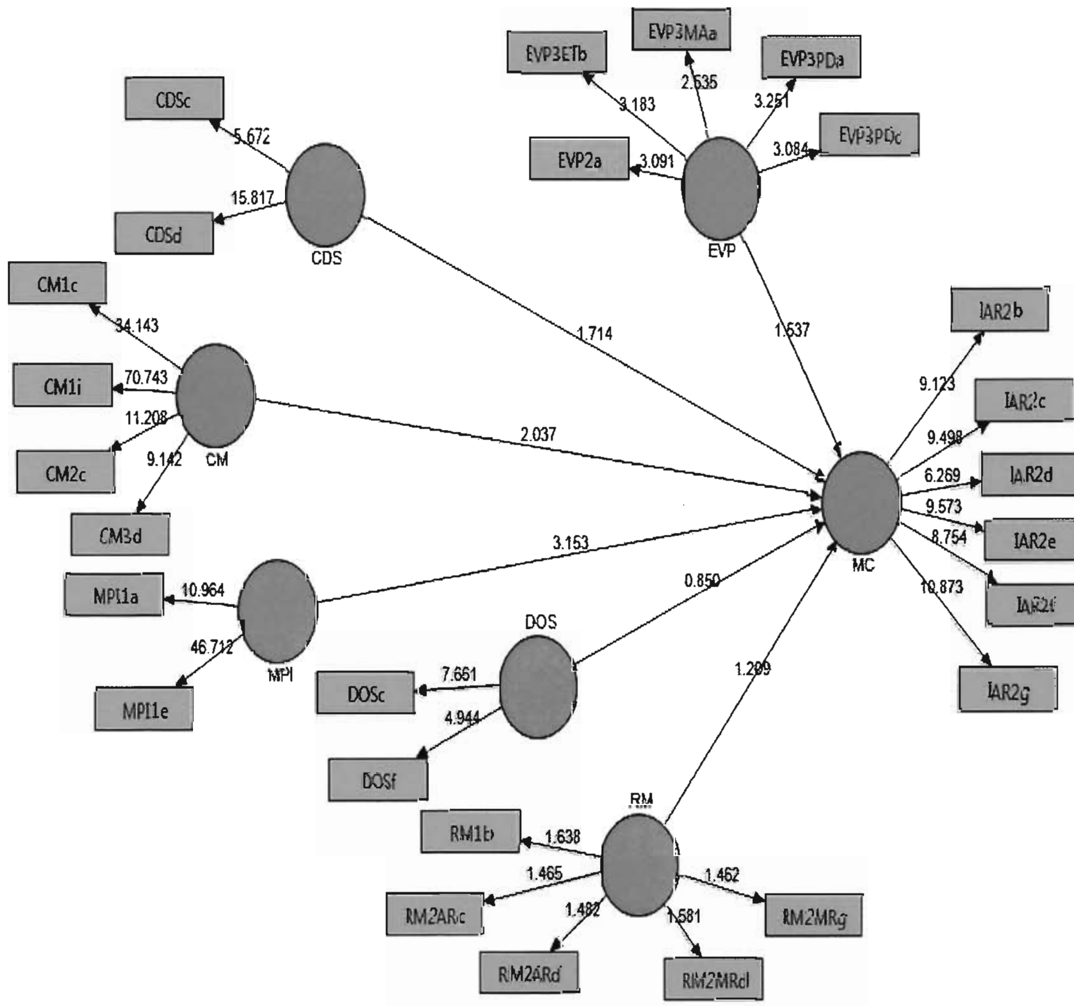


Figure 4.3

The Direct Relationship Between the Independent Variables (Deal Origination and Screening, Evaluating Venture Proposal, Contracting and Deal Structuring, Monitoring and Post Investment Activities and Risk Management) and the Dependent Variable (Management Conflict)

4.4.6 Individual Variable Testing Results

A further testing was equally conducted on the relationship of each individual variable against the dependent variable in examining the contribution of each individual variable to the occurrence of management conflict in venture cooperation. Table 4.7 below shows the overall testing results for the individual variable effect (R^2) for each individual variable and also the overall variables used in this study on the dependent variable.

Table 4.7
Individual Testing Result for the Study's Independent Variables' R^2

Latent Variables	R^2 For Individual Variable	R^2 (Overall R^2 without moderator)
DOS -> MC	0.428830	
EVP -> MC	0.311595	
CDS -> MC	0.407483	0.857095
MPI -> MC	0.764107	
RM -> MC	0.170964	

Even though Deal Originating and Screening (DOS) was found to not have a significant relationship with the dependent variable (Management Conflict, MC) in the overall testing results, the individual testing result on DOS indicates that DOS was individually statistically significant ($\beta = 0.654851$; $p < 0.05$) and individually have a direct effect on the dependent variable (MC). The R^2 for DOS is 0.428830 representing 43% of the variance explained in the dependent variable (MC). Therefore, the 43% variance explained by this independent variable on the dependent variable demonstrates a strong relationship between the independent variable (DOS) and the dependent variable (MC). Thus, the independent variable predicted 43% variance in dependent variable. The direct relationship test results between DOS and MC are shown in Figure 4.4 and Table 4.8 respectively.

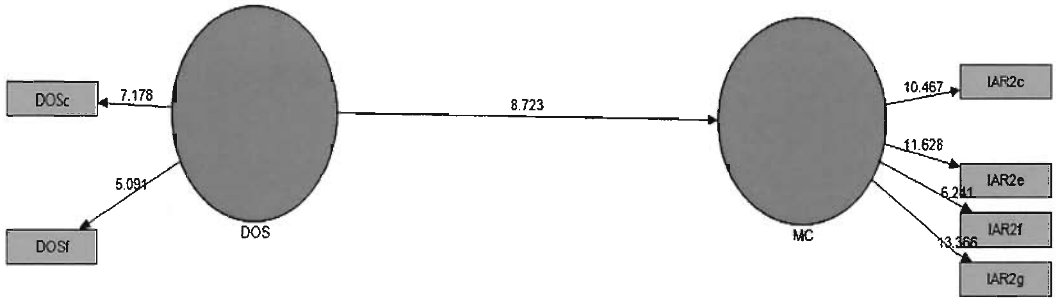


Figure 4.4
The Direct Relationship Between DOS and MC

Table 4.8
Individual Variable Effect for DOS

Relationship	Beta	Standard Error	t -Statistics	P-Value
DOS -> MC	0.654851	0.074910	8.741883	0.05

The result indicates that Evaluating Venture Proposal (EVP) was also individually statistically significant (β = 0.581855; $p < 0.05$) and individually having a direct effect on the dependent variable (MC). The R^2 for EVP is 0.311595 representing 31% of the variance explained in the dependent variable (MC). Therefore, the 31% variance explained by this independent variable on the dependent variable demonstrates a strong relationship between the independent variable (EVP) and the dependent variable (MC). Thus, the independent variable predicted 31% variance in dependent variable. The direct relationship test results between EVP and MC are shown in Figure 4.5 and Table 4.9 respectively.

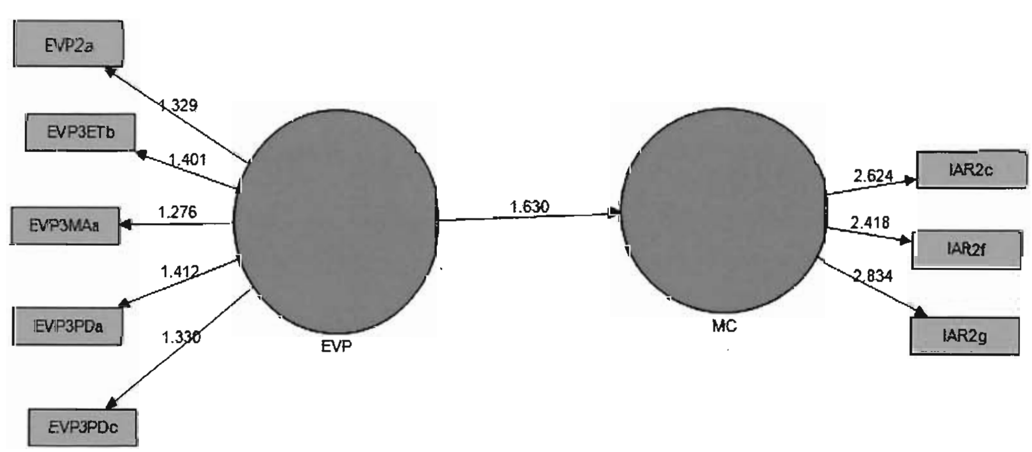


Figure 4.5
The Direct Relationship Between EVP and MC

Table 4.9
Individual Variable Effect for EVP

Relationship	Beta	Standard Error	t -Statistics	P-Value
EVP -> MC	0.581855	0.096076	6.056226	0.05

Furthermore, the result indicates that the Contracting and Deal Structuring (CDS) was also individually statistically significant (β = 0.638344; $p < 0.05$) and individually having a direct effect on the dependent variable (MC). The R^2 for CDS is 0.407483 representing 41% of the variance explained in the dependent variable (MC). Therefore, the 41% variance explained by this independent variable on the dependent variable demonstrates a strong relationship between the independent variable (CDS) and the dependent variable (MC). Thus, the independent variable predicted 41% variance in dependent variable. The direct relationship test results between CDS and MC are shown in Figure 4.6 and Table 4.10 respectively.

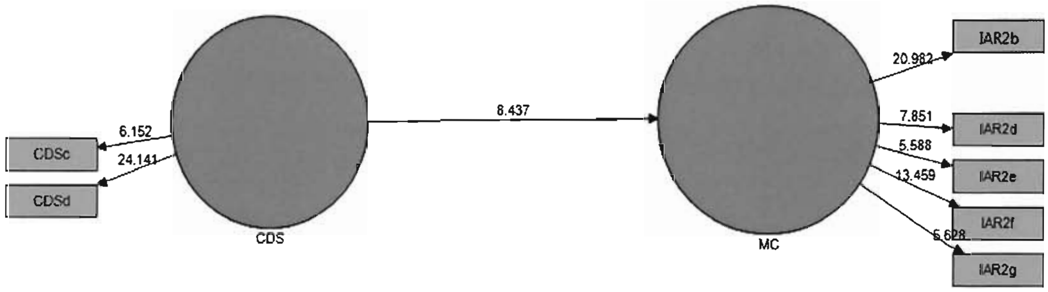


Figure 4.6
The Direct Relationship Between CDS and MC

Table 4.10
Individual Variable Effect for CDS

Relationship	Beta	Standard Error	t -Statistics	P-Value
CDS -> MC	0.638344	0.075663	8.436676	0.05

Likewise, the result indicates that the Monitoring and Post Investment activities (MPI) was individually statistically significant (β = 0.874132; $p < 0.05$) and individually having a direct effect on the dependent variable (MC). The R^2 for MPI is 0.764107 representing 76% of the variance explained in the dependent variable (Management Conflict, MC). Therefore, the 76% variance explained by this independent variable on the dependent variable demonstrates a strong relationship between the independent variable (MPI) and the dependent variable (MC). Thus, the independent variable predicted 76% variance in dependent variable. The direct relationship test results between MPI and MC are shown in Figure 4.7 and Table 4.11 respectively.

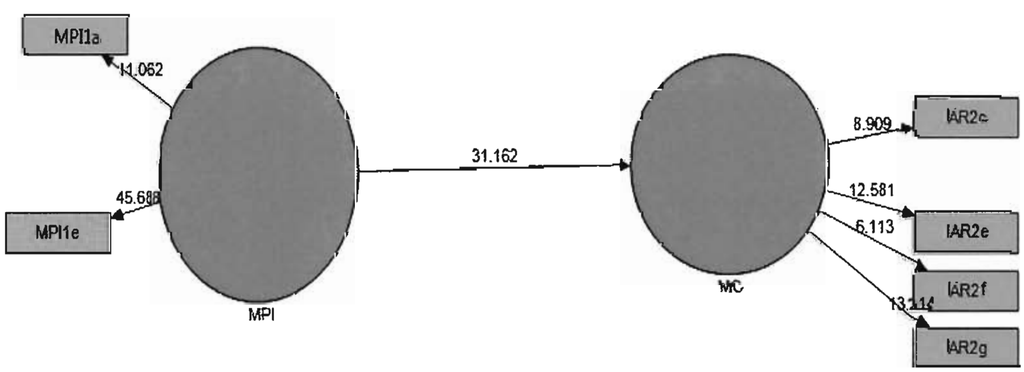


Figure 4.7
7The Direct Relationship Between MPI and MC

Table 4.11
Individual Variable Effect for MPI

Relationship	Beta	Standard Error	t -Statistics	P-Value
MPI -> MC	0.874132	0.028051	31.161986	0.05

Even though Risk Management (RM) was found to not have a significant relationship with the dependent variable (MC) in the overall testing results, the individual testing result on RM indicates that the RM was individually statistically significant ($\beta = 0.413477$; $p < 0.05$) and individually having a direct effect on the dependent variable (MC). The R^2 for RM is 0.170964 representing 17% of the variance explained in the dependent variable (MC). Therefore, the 17% variance explained by this independent variable on the dependent variable demonstrates a fairly strong relationship between the independent variable (RM) and the dependent variable (MC). Thus, the independent variable predicted 17% variance in dependent variable. The direct relationship testing results between RM and MC are shown in Figure 4.8 and Table 4.12 respectively.

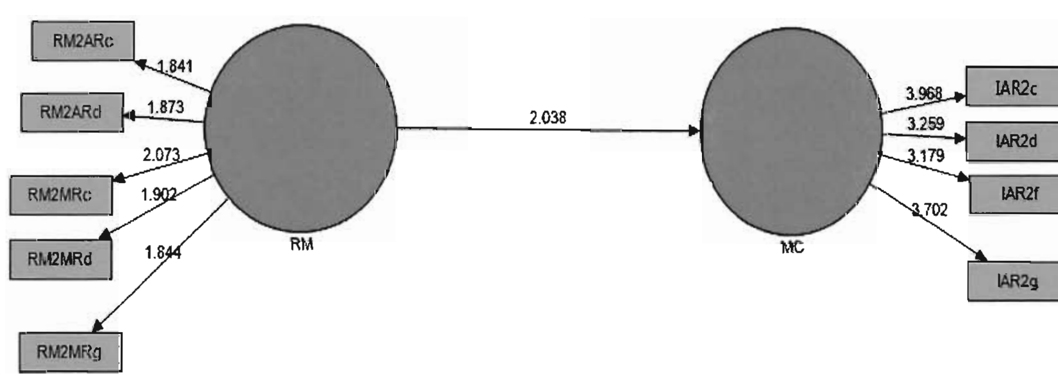


Figure 4.8
The Direct Relationship Between RM and MC

Table 4.12
Individual Variable Effect for RM

Relationship	Beta	Standard Error	t -Statistics	P-Value
RM -> MC	0.413477	0.202859	2.038249	0.05

Also, Table 4.7 indicates the overall R^2 for all the independent variables. The overall R^2 is 0.857095 representing 86% of the variance explained in the dependent variable (MC). Therefore, the 86% variance explained by these independent variables in the dependent variable demonstrates a very strong relationship between the independent variables (deal origination and screening, evaluating venture proposal, contracting and deal structuring, monitoring and post investment activities and risk management) and the dependent variable (management conflict). Thus, the independent variables predicted 86% variance in dependent variable.

4.4.7 The Moderating Effects

To test Hypotheses 7 regarding the moderating effects of controlling mechanism (CM) on the relationship between the independent variables (deal origination and screening, evaluating venture proposal, contracting and deal structuring, monitoring and post investment activities and risk management) and the dependent variable (management conflict), SmartPLS analysis was also conducted. The overall result indicates that the controlling mechanism did not moderate the relationship between all the independent variables (deal origination and screening, evaluating venture proposal, contracting and deal structuring, monitoring and post investment activities and risk management) and dependent variable (management conflict). Further details of this testing results are shown in Table 4.13.

Besides, Figure 4.9 also gives additional information on the moderating effects of controlling mechanism (CM) on the relationship between the independent variables (deal origination and screening, evaluating venture proposal, contracting and deal structuring, monitoring and post investment activities and risk management) and the dependent variable (management conflict).

Table 4.13

The Overall Effects (Mean, STDEV, T-Values)

	Original Sample (O)	Sample Mean (M)	Standard Deviation (STDEV)	Standard Error (STERR)	T Statistics (|O/STERR|)
CDS -> MC	0.175400	0.202381	0.161922	0.161922	1.083240
CDS * CM -> MC	-0.174346	-0.148130	0.222490	0.222490	0.783616
CM -> MC	0.516424	0.475952	0.411818	0.411818	1.254011
DOS -> MC	0.013484	0.026310	0.176935	0.176935	0.076211
DOS * CM -> MC	0.051124	0.031229	0.184505	0.184505	0.277085
EVP -> MC	-0.305329	-0.243761	0.294560	0.294560	1.036559
EVP * CM -> MC	-0.091752	0.043728	0.313468	0.313468	0.292701
MPI -> MC	0.470089	0.396749	0.349639	0.349639	1.344499
MPI * CM -> MC	-0.056407	-0.009936	0.359630	0.359630	0.156848
RM -> MC	-0.055308	0.014785	0.220788	0.220788	0.250503
RM * CM -> MC	-0.235116	-0.017596	0.309017	0.309017	0.760851

4.4.8 The Summary of R^2 Result for the Overall Testing

For the moderating effects assessment, the researcher compared the proportion of variance explained (as shown by the determination of the coefficient, R^2) of the main effect model (i.e. the model without moderating effect) with the R^2 of the full model (i.e. the model with the moderating effect). This is the determination of the effect size at both phases of the analysis.

Table 4.14 provides the information on the overall R^2 (without the moderating effect and with the moderating effect) for the overall analysis. The result of both R^2 shows that there is no change in R^2 when there was no moderator and when the moderator was included. An indication that Controlling Mechanism (CM) is not a significant moderator in the relationship between the independent variable (deal origination and screening, evaluating venture proposal, contracting and deal structuring, monitoring and post investment activities and risk management) and dependent variable (management conflict). Information on both R^2 is presented in Table 4.14.

Table 4.14
The Overall R^2 Without and With the Moderator

Dependent Variable	
Overall R^2 Without Moderator	**Overall R^2 With Moderator**
0.857095	0.857095

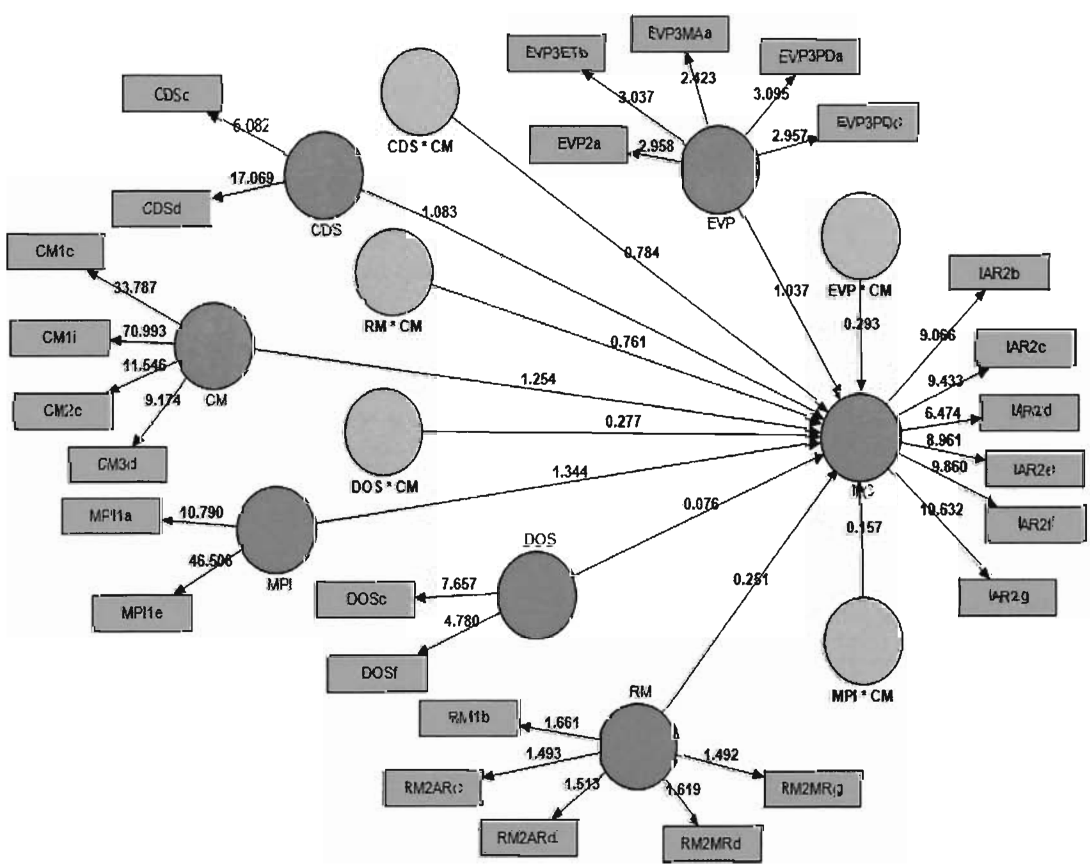


Figure 4.9
The Moderating Effects of Controlling Mechanism (CM) on the Relationship Between the Independent Variables (Deal Origination and Screening, Evaluating Venture Proposal, Contracting and Deal Structuring, Monitoring and Post Investment Activities and Risk Management) and the Dependent Variable (Management Conflict)

4.4.9 The Individual Moderating Testing Results

Further, to test Hypothesis 7 regarding individual moderating effects of controlling mechanism (CM) on the relationship between each of the independent variables (deal origination and screening, evaluating venture proposal, contracting and deal structuring, monitoring and post investment activities and risk management) and the dependent variable (management conflict), SmartPLS analysis was also conducted. The result indicates that controlling mechanism did not moderate the relationship between each independent variables (deal origination and screening, evaluating venture proposal, contracting and deal structuring, monitoring and post investment activities and risk management) and dependent variable (management conflict). Further details of this testing results are shown in Table 4.15.

Table 4.15
Path Coefficients and Hypotheses Testing Results for the Individual Moderating Effect

Hypothesis	Relationship	Beta	Standard Error	t -Statistics	P-Value
H_1	**DOS * CM -> MC**	0.043786	0.118108	0.370732	0.000
H_2	**EVP * CM -> MC**	0.019693	0.155652	0.126517	0.005
H_3	**CDS * CM -> MC**	-0.125750	0.179077	0.702213	0.005
H_4	**MPI * CM -> MC**	-0.003607	0.150150	0.024021	0.000
H_6	**RM * CM -> MC**	-0.164357	0.219491	0.748810	0.000

The results in Table 4.15 indicate that there is no significant moderating effect of controlling mechanism (CM) on the relationship between Deal Origination and Screening (DOS) and the Management Conflict (MC) (ß = 0.043786; t-Statistics = 0.370732). The result also shows that there is no significant moderating effect of controlling mechanism (CM) on the relationship between Monitoring and Post

Investment (MPI) activities and the Management Conflict (MC) (ß = -0.003607; t-Statistics = 0.024021). Further analysis also found that there is no significant moderating effect of controlling mechanism (CM) on the relationship between Risk Management (RM) and Management Conflict (MC) (ß = -0.164357; t-Statistics = 0.748810). The controlling mechanism (CM) is also found to not have a significant moderating effect on the relationship between Evaluating Venture Proposal (EVP) and management conflict (ß = 0.019693; t-Statistics = 0.126517). Besides, the result shows that there is also no significant moderating effect of controlling mechanism on the relationship between Contracting and Deal Structuring (CDS) and management conflict (ß = -0.125750; t-Statistics = 0.702213).

Figure 4.10, 4.11, 4.12, 4.13 and 4.14 give additional information on the individual moderating effects of controlling mechanism (CM) on the relationship between each of the independent variables (deal origination and screening, monitoring and post investment activities, risk management, evaluating venture proposal and contracting and deal structuring) and the dependent variable (management conflict).

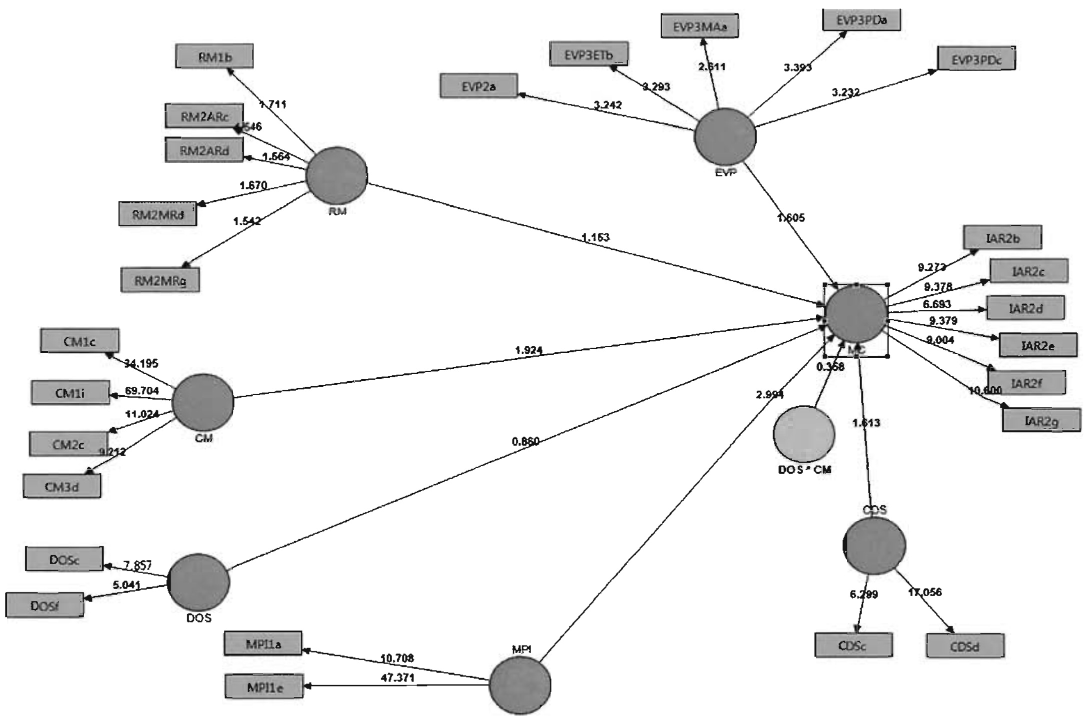


Figure 4.10

The Moderating Effect of Controlling Mechanism (CM) on the Relationship Between Deal Origination and Screening (DOS) and Management Conflict (MC)

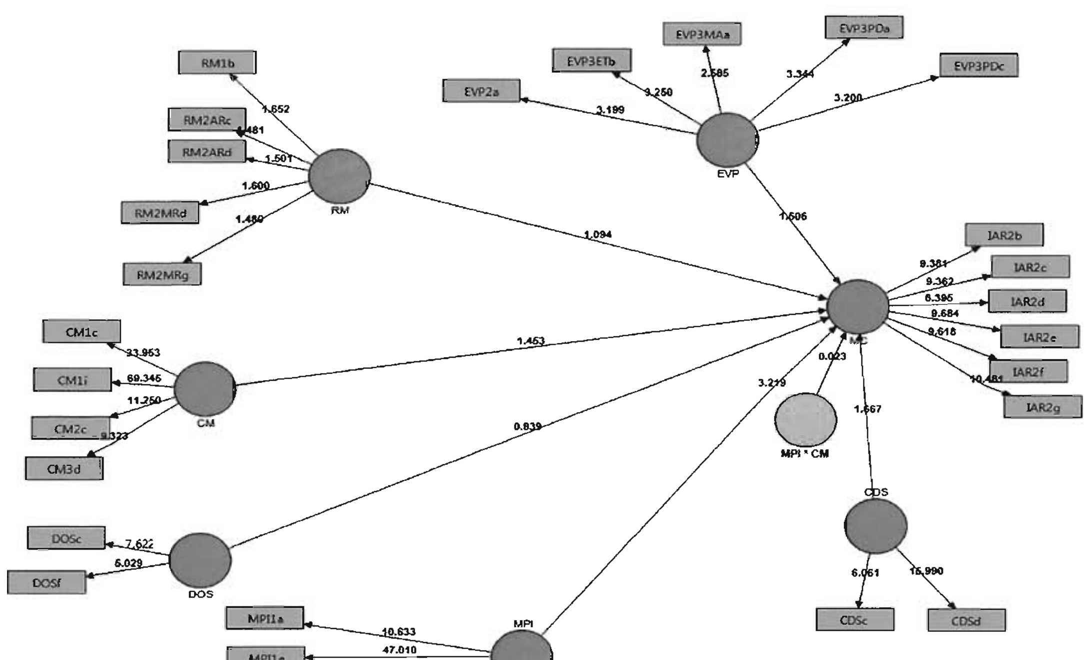


Figure 4.11

The Moderating Effect of Controlling Mechanism on the Relationship Between Monitoring and Post Investment Activities (MPI) and Management Conflict (MC)

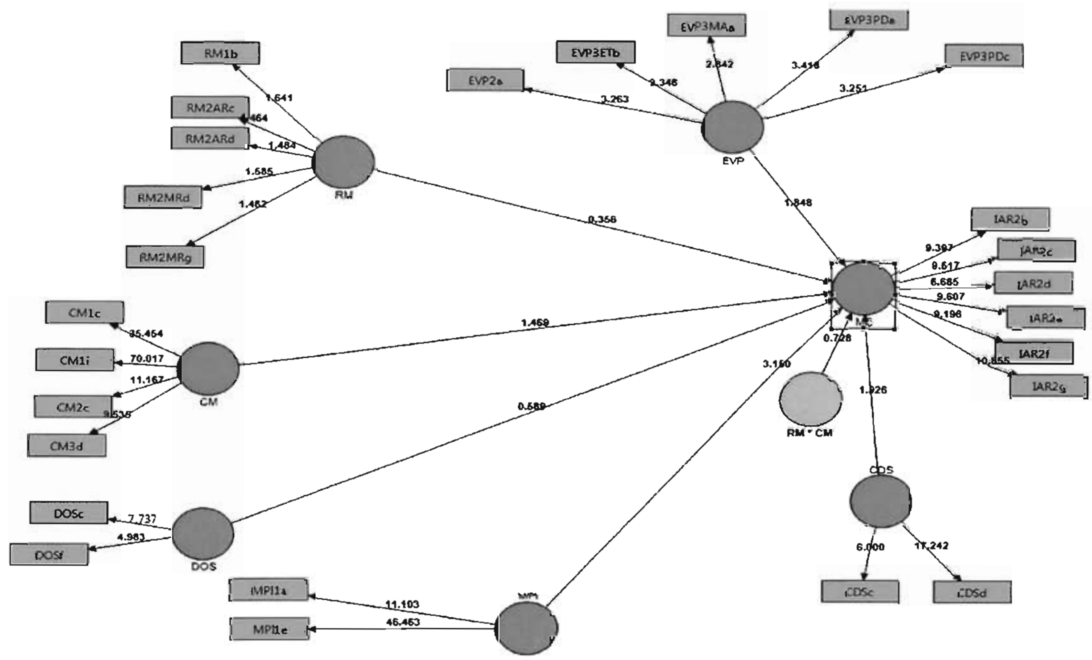


Figure 4.12
The Moderating Effect of Controlling Mechanism (CM) on the Relationship Between Risk Management (RM) and Management Conflict (MC)

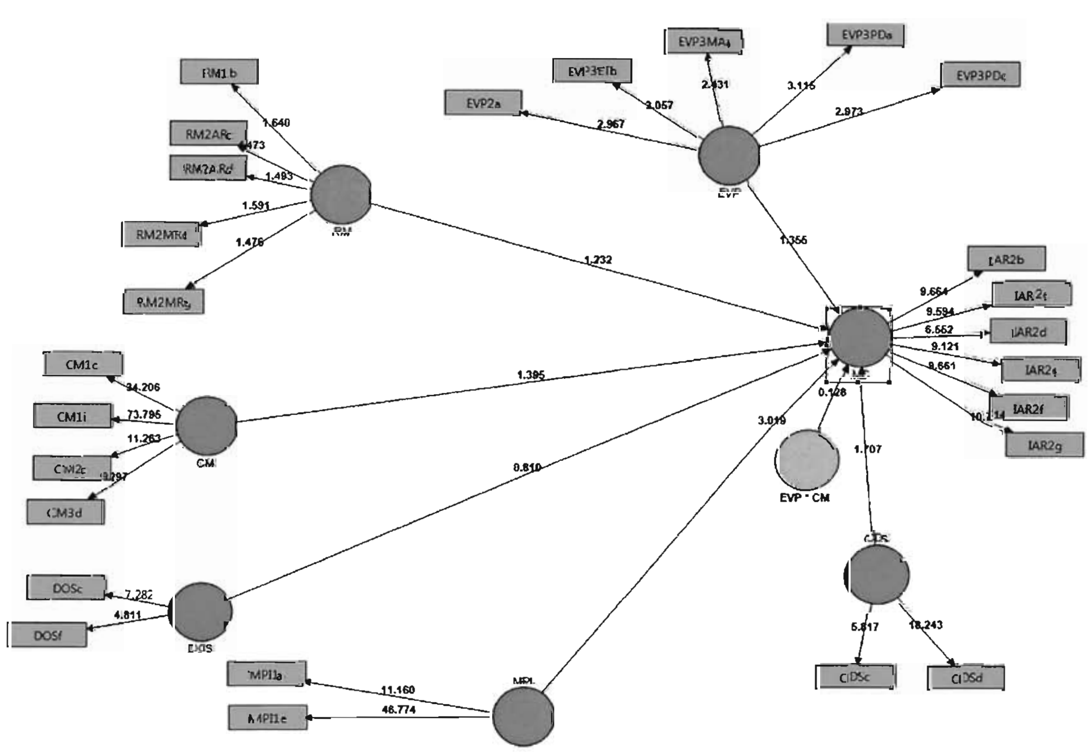


Figure 4.13
The Moderating Effect of Controlling Mechanism (CM) on the Relationship Between Evaluating Venture Proposal (EVP) and Management Conflict (MC)

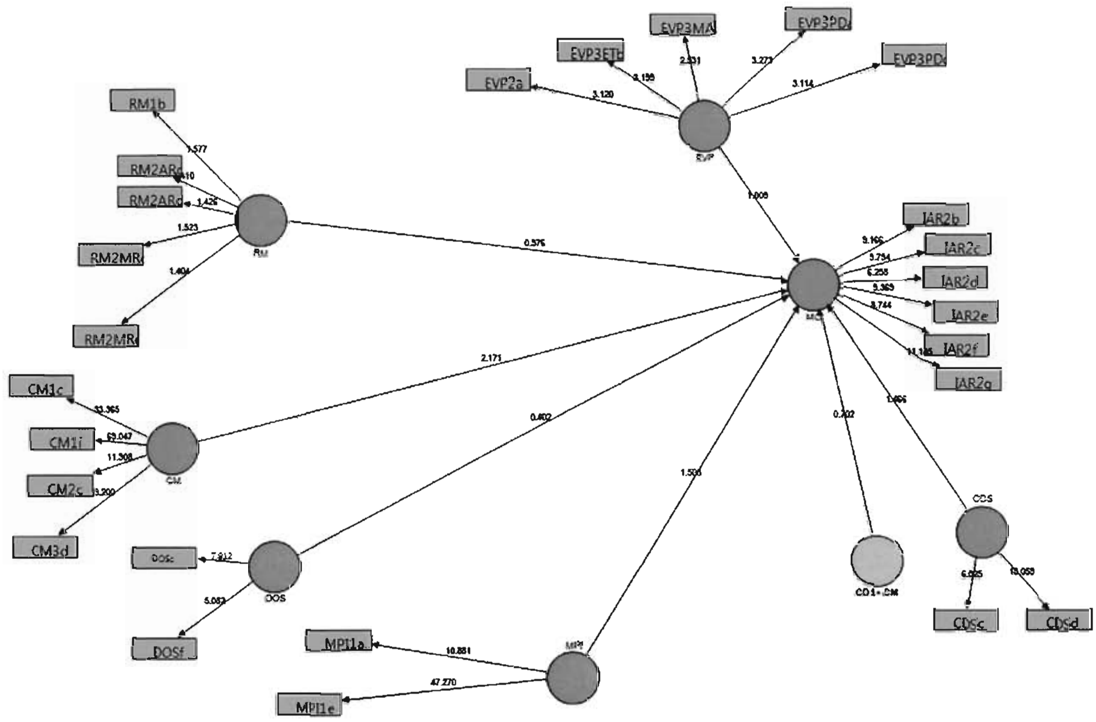


Figure 4.14
The Moderating Effect of Controlling Mechanism (CM) on the Relationship Between The Contracting and Deal Structuring (CDS) and Management Conflict (MC)

4.5 CHAPTER SUMMARY

In conclusion, this chapter discussed the statistical tools used to analyze the data, the study's hypothesis testing results and the moderating effect of a controlling factor through the placement of a nominee director in venture cooperation. The result for each hypothesis testing result including the moderating effect have been analyzed using the SmartPLS to determine the relationship between the independent variables and the dependent variable. The statistical testing results were presented in the tables and appropriate figures to demonstrate the relationship between the independent variables and the dependent variable. The study findings, then were thoroughly discussed in explaining the relationship between the independent variables and the dependent variable.

CHAPTER FIVE

DISCUSSIONS AND CONCLUSIONS

5.1 INTRODUCTION

The major objective of this study is to investigate the management conflict between Malaysian venture capital companies (venture capitalists) and entrepreneurs (investee firms) backed by venture capital financing. The study examined the factors contributing to the occurrence of management conflict between venture capitalists and venture backed firms. Besides, the study also examined the moderating effects of controlling mechanism through the placement of a nominee director on the relationship between the venture capitalists and their investee firms. In other words, the study also examined on how the placement of a nominee director in venture backed firms moderate the relationship between the venture capitalists and their investee firms in venture cooperation.

The chapter discusses on the implications and limitations of the study with recommendations for future inquiry in the area of research. Finally, it also highlights the conclusion based on the results and findings from the hypothesis testing.

5.2 FINDINGS AND DISCUSSIONS

Seven major hypotheses were formulated; (1) there is a significant difference between deal origination and screening and management conflict, (2) there is a significant difference between evaluating venture proposal and management conflict,

(3) there is a significant difference between contracting and deal structuring and management conflict, (4) there is a significant difference between monitoring and post investment activities and management conflict, (5) there is a significant difference between acquiring liquidity and management conflict, (6) there is a significant difference between risk management and management conflict, (7) the controlling factor through the placement of a nominee director has a significant difference on the management conflict. However, the fifth hypothesis was not tested due to the fact that the construct failed both validity and reliability test. Therefore, the construct was excluded from further investigation.

To test these hypotheses, the smartPLS structural equation modeling (SEM) approach by Anderson and Gerbing (1988) was employed. The difference between the main exogenous construct (deal origination and screening, evaluating venture proposal, contracting and deal structuring, monitoring and post investment activities, acquiring liquidity and risk management) and the endogenous construct (management conflict) was first tested.

5.2.1 Direct Effect

For the direct relationship, the overall result indicates that there is a significant relationship between evaluating venture proposal (EVP), contracting and deal structuring (CDS), monitoring and post investment activities (MPI) and controlling mechanism (CM) with management conflict. The results demonstrate that EVP, CDS, MPI and CM contributed directly to the occurrence of management conflict between venture capitalists and their investees in venture cooperation. However, the overall result found no significant relationship between deal origination and screening (DOS) and risk management (RM) with management conflict. In other words, the overall findings demonstrates that DOS and RM did not contributed directly to the occurrence of management conflict between venture capitalists and their investee firms in venture cooperation.

The findings are consistent with the previous study by Gimmon *et al.* (2011), Yitshaki (2008) and Sohaimi (2004) who affirmed that there was a significant relationship between deal origination and screening, evaluating venture proposal, contracting and deal structuring, monitoring and post investment activities and risk management with the management conflict in venture cooperation.

This suggests that management conflict between venture capitalists and their investee firms begins as early as from the venture evaluation stage. The venture evaluation stage is a process where venture capitalists will thoroughly scrutinize business proposals submitted to them prior funding. Therefore, venture capitalists will tend to choose only firms or businesses which are able to promise them an acceptable investment rate of return and at the same time may also comply with all the venture capitalists' investment terms and conditions.

However, the thorough evaluation process may not be fully perfect due to an information asymmetry problem between venture capitalists and the potential firms. In such circumstances, venture capital applicants tend not to reveal certain information needed by venture capitalists due to the nature of the information which they may consider as a part of their trade secrets. This will leave venture capitalists with insufficient information to assist them in making their investment decision, resulting in choosing the wrong firms to be funded. Insufficient information may create differences between venture capitalists and their now so called investee firms as the investees may possess particular information undisclosed to venture capitalists. The differences due to the undisclosed information lead to the occurrence of management conflict between venture capitalists and their investees once the differences between them slowly developed.

The situation will also reflect the contractual and deal structuring between both venture capitalists and venture capital applicants. Such terms and conditions agreed during the contractual and deal structuring stage may not cover some of the areas due to the undisclosed information. Though, as the venture progress, such undisclosed information may be finally revealed by the venture capitalists. Thus, result in venture capitalists to adjust some of their controlling mechanisms used, which may lead to dissatisfaction among their investees. This will finally spark the management conflict to occur between venture capitalists and their investees.

The monitoring and post investment activities along with controlling mechanism employed during the post investment stage were also found to contribute directly to the occurrence of management conflict between venture capitalists and their investees. Such controlling activities employed by venture capitalists during the post investment stage may also create disappointment among the investee firms. The venture capitalists involvement in the investees' business for instance, may be seen by the investees as a situation where they are losing their controlling power over their own firms. Even though the rights and responsibilities for both venture capitalists and investees were clearly defined and explained in the venture contractual agreement between them, the dissatisfaction feeling especially among the investees may still exist. This dissatisfaction may contribute directly to the occurrence of management conflict between the venture capitalists and their investee firms if the conflict occurred prolong and is not resolved.

Further result on the individual variable testing between the independent variables (deal origination and screening, evaluating venture proposal, contracting and deal structuring, monitoring and post investment activities, risk management) and the dependent variable (management conflict) shows that each independent variable was contributing directly to the occurrence of management conflict between venture capitalists and their investees.

The individual variable testing shows that Deal Origination and Screening (DOS) have a significant relationship with the dependent variable (Management Conflict, MC). Even though DOS was found to not have a significant relationship with the management conflict in the overall testing results, the individual testing result on DOS indicates that DOS was individually statistically significant and individually having a direct effect on the management conflict. The R^2 for DOS is 0.428830 representing 43% of the variance explained in the dependent variable (management conflict). Therefore, the 43% variance explained by this independent variable on the dependent variable demonstrates a strong relationship between the DOS and management conflict. Thus, the independent variable (DOS) predicted 43% variance in dependent variable.

The individual testing result also indicates that Evaluating Venture Proposal (EVP) was also individually statistically significant and individually having a direct effect on the dependent variable (management conflict). The R^2 for EVP is 0.311595 representing 31% of the variance explained in the dependent variable (management conflict). Therefore, the 31% variance explained by this independent variable on the dependent variable demonstrates a strong relationship between the independent variable (EVP) and the dependent variable (management conflict). Thus, the independent variable (EVP) predicted 31% variance in dependent variable.

Furthermore, the individual test result indicates that the Contracting and Deal Structuring (CDS) was also individually statistically significant and individually having a direct effect on the dependent variable (management conflict). The R^2 for CDS is 0.407483 representing 41% of the variance explained in the dependent variable (management conflict). Therefore, the 41% variance explained by this independent variable on the dependent variable demonstrates a strong relationship between the independent variable (CDS) and the dependent variable (management conflict). Thus, the independent variable (CDS) predicted 41% variance in dependent variable (management conflict).

Equally, the result indicates that the Monitoring and Post Investment activities (MPI) was also individually statistically significant and individually having a direct effect on the dependent variable (management conflict). The R^2 for MPI is 0.764107 representing 76% of the variance explained in the dependent variable (management conflict). Therefore, the 76% variance explained by this independent variable in the dependent variable (management conflict) demonstrates a strong relationship between the independent variable (MPI) and the dependent variable (management conflict). Thus, the independent variable (MPI) predicted 76% variance in dependent variable (management conflict).

Even though Risk Management (RM) was found to not having a significant relationship with the dependent variable (management conflict) in the overall testing results, the individual testing result on RM indicates that RM was individually statistically significant and individually having a direct effect on the dependent variable (management conflict) . The R^2 for RM is 0.170964 representing 17% of the variance explained in the dependent variable (management conflict). Therefore, the 17% variance explained by this independent variable in the dependent variable demonstrates a fairly strong relationship between the independent variable (RM) and the dependent variable (management conflict). Thus, the independent variable (RM) predicted 17% variance in dependent variable (management conflict).

These findings are also consistent with Gimmon *et al.* (2011), Yitshaki (2008) and Sohaimi (2004) who affirmed that there was a significant individual relationship between deal origination and screening (DOS), evaluating venture proposal (EVP), contracting and deal structuring (CDS), monitoring and post investment activities (MPI) and risk management (RM) with the management conflict in venture cooperation.

5.2.2 Indirect Effect (Moderating Effect)

The placement of a nominee director in the investee firms' board to moderate the venture relationship between the venture capitalists and their investees is found to be inadequate in helping both parties to reduce the management conflict between them. The hypothesis testing results of the moderating effect on the relationship between venture capitalists and their investee firms further indicates that the placement of a nominee director on the investee firms' board of directors gives little or no impact on the relationship between the venture capitalists and their investee firms. Therefore, it is believed that both venture capitalists and investee firms need another superior mechanism or other additional mechanisms to complement the nominee director roles in helping them to successfully moderate the venture relationship and at the same time reduce the potential for the management conflict to occur between the venture capitalists and their investee firms in venture cooperation.

From the directorship perspective, the inability of the nominee director to gives significant impact on the relationship between the venture capitalists and their investee firms is due to the fact that the investee firms' board of directors are consist of several other directors, which represent their own shareholders or principal. Any decision made by the board members normally will be done on a collective basis. Therefore, the placement of a single nominee director on the investee firms' board of directors might not be capable of totally influence the decision made by the overall board members.

5.3 IMPLICATIONS OF THE STUDY

The implication of this study is categorized into two major aspects: theoretical and practical implications which are very relevant to the stakeholders in the area of research.

5.3.1 Theoretical Implications

The study provides more insight on the factors contributing to the occurrence of management conflict between venture capitalists and their investee firms in venture cooperation. One good lesson to learn from this study is, it is important for both venture capitalists and venture capital applicant (the entrepreneur) to have full information disclosure during the venture capital evaluation stage since it may help both the venture capitalists and the entrepreneurs to adequately adjust any differences between them before committing to any capital investment. Such differences if not well addressed may have the potential to spark management conflict in the later stage of their venture cooperation. Together, another mechanism should also be employed to complement the role of a nominee director in monitoring the investee firms' business progress and performance.

Besides, full information disclosure should be continuously enforced throughout the venture cooperation life, especially on the investee firms' side based on what have been stipulated in the venture contractual agreement. Full information disclosure is critical in assisting the venture capitalists in their business decision making. Without full information disclosure, the venture capitalists might face difficulties in making their business decisions since the information they needed in their decision making process are not sufficient or adequate. The investee firms' failure in having full information disclosure is one of the major reasons for the management conflict to occur in any venture cooperation. Therefore, this issue should be well addressed and highlighted by the venture capitalists in their venture capital evaluation process and also in the venture contractual agreement with the entrepreneurs.

The study of conflict in venture capital financing is quite limited as indicated by previous studies. Also, venture capital conflict is still considered as a new discipline in the entrepreneurship management. Therefore, the present study adds to the body of literature in this domain. Besides, the researchers in the area would find this study to be very relevant as the findings would provide a platform for further inquiry in this new area of research.

5.3.2 Practical Implications

The practical implication of this study is categorized into two major groups: the venture capital providers (venture capitalists), the entrepreneurs (investee firms) and the policy makers in which they are very relevant to the area of research.

For venture capitalists, the study has helped to create more awareness on the conflict occurred between them and their investee firms. Venture capitalists should address the asymmetry of information problem, especially during the venture evaluation stage. Asymmetry of information may result in much valuable information to be hindered by entrepreneurs during venture cooperation which may eventually place venture capitalists in a tough situation to make any business decision due to the absence of useful information from their investors. Any legal measures on this particular issue may help venture capitalists in securing useful information from their investee firms without incurring too much cost.

Besides, the findings will also help to guide venture capitalists in the formulation and implementation of policies regarding venture capital financing with special attention given to the prospect firms' full information disclosure requirement prior the evaluation stage. This is vital since full information disclosure will permit venture capitalists to obtain such valuable information from their investee firms which could help them in making their business decision. Besides, the new methods of controlling the investee firms should also be well addressed by the venture capitalists as the alternatives for the existing controlling tools since the placement of a nominee director alone is found to be not sufficient in moderating the relationship between venture capitalists and their investee firms.

For entrepreneurs (investee firms), the model or framework provided in this study serves as a guide to them in taking more proactive actions in avoiding any major conflict that would harm their relationship with venture capitalists. Well exchange of information is vital in any venture cooperation since it helps both venture capitalists and entrepreneurs to have better opportunities in creating successful ventures. Therefore, entrepreneurs need to develop mutual trust with their venture capitalists and should not refuse their responsibilities to share their information with their venture capitalists as it is seen to be able to aid both parties in creating successful venture businesses. This is because the sharing of business information will provide venture capitalists with abundance of useful strategic information which may in turn help them to improve their accuracy in their decision. Accurate and precise decision made by venture capitalists will ultimately improve the opportunity of the venture cooperation in creating a fruitful venture business.

The findings of this study will also help the government and policy makers to address necessary actions and creating a legal framework for the venture capital financing to enable the Malaysian venture capital industry grow and becoming one of the catalysts in helping the country becoming a developed nation in the year 2020. Therefore, any legal framework designed will becomes the major guideline for the local venture capital investment and will contribute to the future development of the Malaysian venture capital industry.

5.4 LIMITATIONS AND RECOMMENDATIONS FOR FUTURE STUDY

Three major limitations are identified in this study and discussed below:

5.4.1 Limited Data

The data for this study is limited due to the small population size of the Malaysian venture capital companies. The use of quantitative research approach may have influenced the findings due to the limited number of respondents as indicated in this study. Therefore, using qualitative approach in the future research could offer more insight in this domain on the influence of venture capitalists, and entrepreneurs on the management conflict. Hence, similar studies in this area are needed, especially those with the usage of different data collection method, since it will allow the researcher to perform in depth studies in investigating the management conflict in venture cooperation. We recommend a similar study in this area with a qualitative approach in a different environment.

5.4.2 Small Population Size

The population of Malaysian venture capital companies is relatively small compared to other countries. Thus, it reflects the number of responses received for this study during the data collection period. Therefore, the same study setting, but in regional context may be needed as it will give a clearer view on the management conflict between venture capitalists and their investees. Hence, broadening the population size to the regional level in the future research could also offer more insight in this domain on the influence of venture capitalists, and entrepreneurs on the management conflict.

5.4.3 Different Research Environment

The research environment and study setting for this study is limited to the Malaysian context. Therefore, the data for this study only represents Malaysian venture capitalists and entrepreneurs. Hence, it is recommended that this study should be duplicated in other research setting or environment in order to validate the data and extend the generalization of the findings in this study.

5.5 CONCLUSION

Based on the findings obtained in this study, the following conclusions are highlighted:

1. **Independent Variables Predict Management Conflict**

   The independent variables, namely deal origination and screening, evaluating venture proposal, contracting and deal structuring, monitoring and post investment activities and risk management are the factors that can predict the occurrence of management conflict between venture capitalists and their investees in venture cooperation.

2. **That Independent Variables Are Very Relevant Factors to Effect Management Conflict**

   The independent variables, namely deal origination and screening, evaluating venture proposal, contracting and deal structuring, monitoring and post investment activities and risk management contribute directly to the occurrence of management conflict between venture capitalists and their investees in venture cooperation.

3. **Controlling Mechanism is Not a Significant Moderating Variable in Relation Between the Venture Capitalists and the Investee Firms**

   Venture capitalists may use controlling mechanism by placing a nominee director in their investees' board to monitor the venture progress and at the same time moderating the venture capitalists – investees' relationship in an attempt to reduce any management conflict that may occur between them. However, this mechanism is not adequate as the appointment of a nominee director is seen to give little or no moderating impact on the conflict occurring between venture capitalists and their investees.

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