



Intangible Capital

ISSN: 2014-3214

ic.editor@intangiblecapital.org

Universitat Politècnica de Catalunya
Espanya

Ramón-Llorens, M^a Camino; Hernández-Cánovas, Ginés
The venture capital contract and the Institutional Theory in a Spanish setting
Intangible Capital, vol. 9, núm. 1, 2013, pp. 322-340
Universitat Politècnica de Catalunya
Barcelona, Espanya

Available in: <http://www.redalyc.org/articulo.oa?id=54926344007>

- How to cite
- Complete issue
- More information about this article
- Journal's homepage in redalyc.org

redalyc.org

Scientific Information System

Network of Scientific Journals from Latin America, the Caribbean, Spain and Portugal

Non-profit academic project, developed under the open access initiative

The venture capital contract and the Institutional Theory in a Spanish setting

M^a Camino Ramón-Llorens, Ginés Hernández-Cánovas

Universidad Politécnica de Cartagena (Spain)

camino.ramon@upct.es, ginés.hernandez@upct.es

Received: December 2012

Accepted: March 2013

Abstract

Purpose: This paper examines the principles of the Institutional Theory in order to increase the understanding of the contractual covenants that Spanish venture capital firms use in their relationship with the portfolio companies.

Design/methodology/approach: The study is based on the data obtained by means of a postal survey addressed to the 70 Spanish venture capital firms registered in the ASCRI (Asociación Española de Entidades de Capital Riesgo) in June, 2002, with a response rate of 68.33%. As a theoretical framework we base on the Institutional Theory as a mechanism to understand the venture capital contractual process.

Findings: The results show that a large part of the Spanish venture capital contracts are homogeneous. However, between public and private venture capital firms there is some heterogeneity not only in relation to the industry but also within the field in the design of contracts. It might be due to the coercive pressures exerted by the government on public entities.

Research Limitations: Although survey data might create potential biases and possible measurement problems, we consider that our sample has large enough coverage of the venture capital industry (68.33%) that, although cautiously, valid conclusions can be drawn.

Originality/value: To the best of our knowledge, this study is one of the first empirical contributions analyzing financial contracts of venture capital firms in Spain. A better understanding of covenants included in venture capital contracts can help Spanish firms to understand the particular terms and restraints of venture capitalists before providing

capital. Moreover, this paper also has clear benefits for policy makers and venture capitalists.

Keywords: Venture capital contract, Institutional Theory

JEL Codes: G24

Introduction

The work of Suchman (1995) proposes the Institutional Theory as a mechanism to understand the venture capital contractual process, based on the idea that social and cultural pressures become established as a rule for social behaviour. The Institutional Theory states that organizations and their strategies are influenced by the institutional settings in which they operate, and shaped by the institutional legacies which reflect the culture, history, and polity of the particular country or region (Doh & Guay, 2006), making organizations homogenous over time (DiMaggio & Powell, 1983).

DiMaggio and Powell (1983) call this tendency toward homogeneity "isomorphism", identifying three isomorphic forces: coercive, mimetic and normative. As a consequence of these forces in the industry, one might expect the behaviour of the venture capitalists (VCs) as a whole to be quite homogeneous when choosing the covenants that will regulate their relations with the companies they invest in (Jog, Lawson & Riding, 1991 in Canada; and Isaksson, Cornelius, Landström & Junghagen, 2004 in Sweden). For example, less experienced venture capitalists will copy the covenants included by their more experienced counterparts in the industry (Isaksson et al., 2004). It is also possible that some organizational fields within the industry are more homogeneous than others, originating differences in the use of covenants between fields. Empirical evidence provided by Isaksson et al. (2004) shows the existence of differences in the use of covenants between public and private venture capital firms (VCF), or between early and later stage investors. Due to this heterogeneity, the same business proposal might obtain different treatment depending on the venture capitalists that the entrepreneur approaches. This creates uncertainty and could discourage entrepreneurs from applying for venture financing.

Following the above theory and the existing evidence, the objective of this paper is twofold. Firstly, we analyze whether Spanish venture capitalists in our sample are homogeneous as a whole when writing their contracts with the investee company. Our results show that Spanish venture capital firms in our sample are quite homogeneous. There are not covenants hardly used by a high number of venture capitalists and 36% of the covenants are almost always included in their contracts by more than 80% of the companies. However, some degree of heterogeneity in the industry as a whole arises because 64% of covenants are only used by

venture capitalists for specific situations and purposes. The second objective consists of checking whether there are some organizational fields that are more isomorphic than others. We find the existence of differences in the design of contracts between public and private venture capital firms that, contrary to our expectations, arise due to a lower degree of isomorphism within the group of public companies. It seems that coercive pressures exerted by the government on public entities make their behavior heterogeneous not only in relation to the industry but also within the field.

We carry out our analyses using a survey dataset of 41 Spanish venture capital firms providing information regarding contractual arrangements used in their relationship with their portfolio companies. We think that our sample perfectly suits our objective due to the important expansion that the Spanish venture capital sector has experienced since the end of the twentieth century. Venture capital finance has been central in promoting the development of new technologies, job creation, economic growth and the regional development, which help to develop and consolidate a new category of entrepreneurs, who are more innovative, better trained and more dynamic. It should be also highlighted the significant financing gap of Spanish small and medium-sized firms (SMEs), which makes the venture capital sector one of the main players to many SMEs that are rapidly growing or that are developing high risk products (Del Palacio, Zhang & Sole, 2012). In fact, the Spanish VC sector is basically focused on SMEs, helping them to grow faster, create more jobs, and invest more forcibly than non-financed firms in the sector.

Our paper yields two specific contributions. First, up to the best of our knowledge this is the first paper analyzing the association between venture capital contracts and the Institutional Theory in Spain. And second, our findings uncover the existence of unexpected heterogeneity in the venture capital industry within the field of public own organizations. Further research on this topic will show whether this heterogeneity is the result of greater flexibility or discretionary behaviour from public venture capitalists.

The paper proceeds as follows. Section 2 discusses previous research. Section 3 presents the data and method. Section 4 presents the results, and section 5 concludes.

The Institutional Theory

According to Bruton, Fried and Manigart (2005), VCs are subject to different institutional forces which can influence their behaviour. These institutional forces are studied by the Institutional Theory, which considers the process by which organizations adapt to the social and cultural pressures of the institutional environment in order to achieve legitimacy, become established as a rule for social behaviour and make organizations homogenous over time. DiMaggio and Powell (1983) call this tendency toward homogeneity "isomorphism", which occurs when

organizations seek cultural and political legitimacy. The institutional isomorphism takes place through three types of mechanisms defined by DiMaggio and Powell (1983): (1) coercive isomorphism is an exogenous force arising from political pressures and the need for legitimacy, (2) normative isomorphism is an endogenous force that stems from the influence of the professionalization and the role of education, and (3) mimetic isomorphism is an endogenous force resulting from circumstances of uncertainty.

DiMaggio and Powell (1983) claim that the three institutional mechanisms create and diffuse a common set of values, norms, and rules to produce similar practices and structures across organizations that share a common organizational field. Organizational field is defined by DiMaggio and Powell (1983) as “those organizations which, in the aggregate, constitute a recognized area of institutional life: key suppliers, resources and product consumers, regulatory agencies, and other organizations that produce similar services or products”. Throughout institutionalization these rules are embedded within an industry or the society as a whole and become a guide for people and firms, reducing uncertainty and providing stable structures for human interaction (North, 1990). Institutions are defined as norms, or behavioral traits that guide human conduct explaining what is and is not, what can be acted upon and what cannot (Hoffman, 1999). North (1990) differentiates between formal and informal institutions. Formal institutions are laws and regulations usually supported by coercive forces. Whereas informal institutions include taboos, norms, conventions, traditions and codes of conduct supported by mimetic and normative pillars.

The coercive dimension of the Institutional Theory is the most formal institution, and refers to exogenous pressures exerted on one organization by another in which the first one is dependent (DiMaggio & Powell, 1983; Scott, 1995). This regulatory dimension of the Institutional Theory is driven by the provisions of government legislation (North, 1990), as well as industrial agreements and standards (Bruton, Ahlstrom & Han-Lin, 2010), that control the behavior of firms (North, 1990). In VC context, government action or state intervention play an important role in the development of institutional legitimacy by exerting pressure through their control of funding, or by the exercise of their power to regulate (Frumkin & Gelaskiewicz, 2004; Cornelius, 2005). Public venture capitalists as perceived by policy makers have goals similar to their own (Cornelius, 2005), such as the promotion of a region's economic growth or small firm's growth rather than obtaining a high profitability (Jeng & Wells, 2000; Cumming & MacIntosh, 2006; Brander, Egan & Hellmann, 2009; Munari & Toschi, 2010). As a consequence, coercive isomorphism should be stronger in the organizational field of public venture capital firms, resulting in differences in the use of covenants between public and private VC firms.

The normative elements of institutions are the expected behavior of individuals and organizations which are propagated through teaching and training (DiMaggio, 2001). Normative isomorphism is usually associated with the pressures arising from the role of

professionalization, which leads to similar forms in a particular organizational field. DiMaggio and Powell (1983) emphasize that professionalization is the collective effort of members of an organization in order to define the conditions and methods of their work. In VC context, venture capitalists are trained in the same educational context and share similar cultural and economic background as well as norms regarding the appropriate way of working in the profession. Therefore, the normative pressures derived from VCs' professionalization drives the contractual behaviour towards standardization.

Cultural-cognitive institutions represent informal taken for granted rules and common shared beliefs that are established among individuals through social interactions (Scott, 1995). These culture/cognitive institutions were called mimetic isomorphism by DiMaggio and Powell (1983), which arise in response to environments of great uncertainty and involve the imitation of the behaviour, structures and practices of more successful or more legitimate organizations, in order to increase their chances for survival. Since VCs-entrepreneur relationship is characterized by risk and uncertainty (Tykvová, 2007), the most successful VC firms will be imitated by the less successful ones, driving the VC contracting behavior toward standardization.

Empirical evidence regarding the development of Institutional Theory as an instrument to understand the financial contracts in the venture capital industry is scarce. Suchman (1995) examines 108 financial contracts from two important venture capital funds in California's Silicon Valley, during the period 1975-1990. They find that venture capital contracts become standardized over time due to normative isomorphism and that standardization declines with geographical distance from Silicon Valley. Later, in Sweden, the Institutional Theory supports the results provided by Isaksson et al. (2004). They find some differences between public and non-public venture capital firms that may result from the political pressures on public organizations. Private venture capitalists turn towards standardized covenants, whereas the public ones lean towards situational elements. Their results do not show many differences between the contractual choices made by more or less experienced venture capitalists. Finally, they find that early and late stage investors are two different organizational cultures controlling the design of contracts in these groups.

Data and methodology

In this section we present the data and methodology we use in our analyses to study the influence that the institutional forces might have on the standardization of venture capital contracts.

Data

The Spanish venture capital industry grew significantly until 2000, in terms of both capital available for investment and the number of Spanish firms participating in the market. However,

it was at this point when the crisis arrived to the technological market, that the European sector in general and the Spanish one in particular suffered its consequences. This meant the end of the continued growth in investment activity, which fell from 1,320 million Euro in 2000 to 972 million Euro in 2002 (Data provided by the Spanish association of venture capital, ASCRI).

We obtain the data by means of a postal survey addressed to the 70 Spanish VCF registered in ASCRI in June, 2002. The design of the questionnaires received valuable contributions provided by prestigious economists specialized in financial risk assessment and particularly related with the valuation of ventures. Before sending out the questionnaire, we contacted the 70 VCF to check their willingness to participate in the survey and identify the person in charge of taking the funding decision. Three of the companies were reluctant to answer the surveys, one was unreachable, and six had not made venture capital operations in recent years. From the 60 postal questionnaires that finally were sent, 41 questionnaires were received until February 2003, which corresponds to a response rate of 68.33%.

In table 1 we display some descriptive statistics of VC firms in our sample. We observe that the average VCF is 9.54 years old, has almost 11 employees, made investments and has 20 companies in its portfolio. Table 1 also shows the heterogeneity of our sample, where the age of the firms ranges from 1 to 21 years old, firms have between 1 and 77 employees, the number of investments ranges from 0 to 21, and venture capital firms have between 1 and 95 companies in their portfolio (this information was obtained from ASCRI yearbook 2003).

	Mean	Min.	Max.	S.D.
Age of VC firm (in years) (N = 41)	9.54	1	21	6.61
Number of employees in 2003 (N = 41)	10.54	1	77	12.39
Number of investments in 2003 (N = 35)	6.06	0	21	5.67
Number of companies in the portfolio (31.12.2003) (N = 33)	20.02	1	95	22.20

N is the number of available observations for each characteristic of the venture capital firm

Table 1. Descriptive statistics on the respondents

Methodology

Since some organizations field might be more standardized than others as a result of institutional pressures within the field, we perform a discriminant analysis in order to determine whether there are any differences between venture capitalists' contractual choices depending on the venture capitalist's experience, investment strategy or the origin of the resources. The discriminant analysis is conducted because it is a technique that allows for the identification of variables that best discriminate between two or more groups in order to identify if certain groups of VCs act in a similar way.

To carry out the discriminant analysis we use the variables that construct our hypothesis as the dependent variables, i.e. firm structure (public or private capital), development stage (the preference for early or late-stage investments) and VCs' experience or inexperience. As for the independent variables, we use the 25 covenants. We perform the analysis by stepwise inclusion method in order to minimize Wilk's Lambda in each step.

Variables

Independent variables

Using a five-point Likert scale (1 = little important; 5 = very important) the questionnaire collects information concerning the most important venture capital contractual covenants identified by previous empirical literature.

Based on previous research, we have classified the covenants into four dimensions, which allow us a better study and understanding of the venture capitalist's behaviour in designing the financial contract: 1) contractual covenants in the pre-investment relationship, 2) contractual covenants in the post investment relationship management, 3) contractual covenants in specific events in post investment period and 4) exit covenants. Out of 25 covenants, 1 belongs to the pre-investment agreements category, 17 are classified in the post-investment relationship management, 5 covenants included to control for specific events in the post investment period, and finally 2 are exit covenants.

Table 2 shows the means and standard deviations of our independent variables by groups and ranked in descending order. The most significant contractual covenants are related to the post investment relationship management, being the most important the periodic presentation of accounting states with a mean of 5.00, followed by periodic economic-financial reports (4.95), yearly audits (4.95) and the presentation of the next budget (4.90). All these variables represent the venture capitalist's rights to be informed regarding the situation and evolution of the company. The least important covenants are those that impose limitations on contracting external advisors (2.65), that negotiate their contract's length with managers (2.93) and that control for the reliability of the information provided in the business plan (2.97).

Dependent variables

We classify firms in our sample into experienced or inexperienced using the median of the age of the VC firm, which we calculate as the number of years since the foundation of the company until 2003 (when we receipt the last questionnaire). We find a positive correlation between the most experienced VC firms and the number of total investments made since the company was founded (Cornelius & Hargreaves, 1991; Isaksson et al., 2004). As for the origin of the resources and the investment strategy, we split our sample into public or private VCF and

investors focused on early or late stage of development projects respectively using their own assessment given in the survey.

	Overall mean n=37	Standard Deviation
Pre Investment agreements		
Control for the reliability of the information provided in the business plan (due diligence)	2.97	1.13
Post Investment Relationship Management		
Periodic presentation of accounting states	5.00	0.00
Periodic economic-financial reports	4.95	0.21
Yearly audits	4.95	0.21
Presentation of the next budget	4.90	0.62
Information about substantial matters which may affect any aspect of the business	4.78	0.52
Right of VCs to participate in Bo D	4.68	0.82
Veto rights of VCs on important decisions	4.54	0.89
Veto Rights of the VCs in particular agreements	4.32	1.12
Veto rights on new issue of shares	4.24	1.20
Stand Still agreement	3.85	1.29
Veto rights on executive's salary	3.59	1.48
Limitation on important expenses are established	3.51	1.41
Managers cannot spread the own technology	3.51	1.36
Non-competition clause	3.44	1.50
Limitation on the external indebtedness of the company	3.39	1.37
Limitation on loan, transfer or advance in loan to administrators	3.34	1.40
Limitations on contracting external advisors	2.65	1.35
Specifics Events In Post Investment Period		
Anti-dilution ratchet	4.48	0.93
It provides a compensation for breach of contract	3.76	1.52
The VC Firm can to intervene if the objectives are not achieved	3.71	1.23
VC has the power to force changes in the Bo D	3.20	1.52
A dateline is fixed for the VCF to complain about errors or omissions	3.05	1.60
Exit		
Timing of exit	3.66	1.27
Length of contract	2.93	1.23

Measured on five point Likert scale: 1 (I completely disagree) to 5 (I completely agree). We limit our analyses to the 37 VCF that give their scores in all the variables.

Table 2. Contractual covenants in VC

Table 3 shows that the capital is private in 30 venture capital firms (73.17%), which are mostly inexperienced and later stage investors (25 out of the 30 firms). Among the 11 public venture capital firms, it is remarkable that there are 9 experienced organizations, probably because the beginning of this industry in Spain was trigger by government intervention. Venture capitalists in our sample show a clear preference (31 or 75.61% of the sample) by investments in late

stages of development (post-creation or expansion financing), being 21 of them organizations with little experience. Finally, it should be highlighted that 27 organizations (65.85%) are classified as inexperienced.

	VC structure			
	Public	Private	Row Total	Significance
Development stage				
Early	5 (45.46%)	5 (16.67%)	10 (24.39%)	*
Late	6 (54.54%)	25 (83.33%)	31 (75.61%)	*
<i>Column total</i>	<i>11 (26.83%)</i>	<i>30 (73.17%)</i>	<i>41 (100%)</i>	
	VC structure			
	Public	Private	Row Total	Significance
VC experience				
Experience	9 (81.82%)	5 (16.67%)	14 (34.15%)	***
Inexperience	2 (18.18%)	25 (83.33%)	27 (65.85%)	***
<i>Column total</i>	<i>11 (26.83%)</i>	<i>30 (73.17%)</i>	<i>41 (100%)</i>	
	VC experience			
	Experience	Inexperience	Row Total	Significance
Development stage				
Early	4 (28.57%)	6 (22.22%)	10 (24.39%)	
Late	10 (71.43%)	21 (77.78%)	31 (75.61%)	
<i>Column total</i>	<i>14 (34.15%)</i>	<i>27 (65.85%)</i>	<i>41 (100%)</i>	

Statistical significance at the 10%, 1% level is indicated by *, ***, respectively

Table 3. Venture capital fund characteristics

Results

Description of covenants

For each VCF we reclassify our independent variables in a new scale consisting in three levels. Variables that take on the values 1 and 2 have been classified as seldom used, those covenants that score 3 are classified as sometimes used, and finally variables that take on the values 4 and 5 are classified as almost always used.

Next, each term is classified as rare, situational or standard. When a term is seldom used by over 80% of the respondents, it is called rare. When a term is almost always used by over 80% of the respondents, it is called standard. The 80% cut-off is selected following the scheme proposed by Isaksson et al. (2004). Finally, covenants that can't be classified as either standard or rare are classified as situational. In table 4 we observe that 9 covenants (36% of the covenants used by VCs in our sample) are classified as standard, whereas 16 (64%) are situational covenants used to deal with specific contexts. No covenants are rare (further detail of covenants included in each category can be found in Appendix C). These

results suggest the existence of some heterogeneity in the design of contracts through the inclusion of the so call “situational covenants”.

Type of term	Frequency	%
Number of rare	0	0
Number of situational	16	64
Number of standard	9	36
Sum	25	100

Table 4. Summary of rare, situational and standard covenants

Differentiating strategies

Although the above analyses confirm that venture capital contracts are mostly standardized, our results also show the existence of some degree of heterogeneity. Therefore, in this section we want to assess the origin of those differences in the design of the contracts.

We use a discriminant analysis in order to determine whether there are any differences between venture capitalists’ contractual choices depending on their experience, investment strategy and fund structure. We carry out the discriminant analysis using the firm structure (public or private capital), the investment strategy (the preference for early or late stage investments) and VCs’ experience or inexperience as dependent variables. As independent variables we use the 25 covenants included in the survey. The analysis is performed by stepwise inclusion method in order to minimize Wilk’s Lambda in each step, resulting in a 100% of correctly classified observations.

As we can see in table 5, most of covenants do not discriminate between venture capital firms grouped according to their experience (91.67%) or investment preferences (83.33%), suggesting that normative and mimetic pressures drive financial contracts towards standardization. However, 11 out of the 24 contractual covenants (45.83%) discriminate between public and private venture capital firms. Opposite to the results provided by Isaksson et al. (2004), investment preferences do not seem to influence the design of contracts for venture capital firms in our sample. Results regarding the experienced and venture capital structure are in line with those presented by Isaksson et al. (2004).

	Experience		Investment Preference		Firm structure	
	No.	%	No.	%	No.	%
Variables that do not discriminate	22	91.67	20	83.33	13	54.17
Variables that discriminate	2	8.33	4	16.67	11	45.83

The variable “Periodic presentation of accounting states” has been omitted from this analysis because it always takes on the value 5.

Table 5. Discriminant analysis on the three dependent variables

In table 6, we observe that those 2 contractual covenants discriminating between experienced and inexperienced firms are related with the situational loyalty clauses in the ‘post investment relationship management’ (non-competition clause and not spread the own technology). In addition, the non-competition clause is situational for the experienced VCs and standard for the inexperienced ones.

	Experienced			Inexperienced		
	Rare	Situat.	Stand.	Rare	Situat.	Stand.
Post Investment Relationship Management						
Non-competition clause		x				x
Managers cannot spread the own technology		x			x	

Table 6. Analysis of rare, situational and standard covenants for experienced and inexperienced VCs

Table 7 shows that among VCF preferring early stage investments, only 25% of the covenants are standard, while for those that prefer to invest in late stages 50% correspond to standard covenants. The main difference between the two groups is the veto rights that the venture capitalists have in particular agreements, which is situational for early stages and standard for later stages. Due to the high level of risk and uncertainty, the high risk of failure and the lack of a strong legal system surrounding the early stage investments, VCs depend on previous experience in selecting new ventures (Elango, Fried, Hisrich & Polonchek, 1995; Ruhnka & Young, 1987, 1991; Klausner & Litvak, 2001; Hyytinen & Toivanen, 2003; Bruton et al., 2005). Therefore, when VCs make an investment in early stages of development, they tend to rely on their previous experience or they try to mimic the contractual arrangements of late stage investments.

	Early			Late		
	Rare	Situat.	Stand.	Rare	Situat.	Stand.
Post Investment Relationship Management						
Veto Rights of the VCs in particular agreements		x				x
Presentation of the next budget			x			x
A dateline is fixed for the firm to complain about errors or omissions		x			x	
Exit						
Length of contract		x			x	

Table 7. Analysis of rare, special and standard covenants for early and late VCs

Finally, public vs. private venture firms’ contractual choices are assessed (firm structure) in table 8. Among public VCF, 36.36% of the covenants are rare, while for the private ones

36.36% correspond to standard covenants. A rare covenant for the subsample of public venture capital firms means that there are “seldom used” covenants used by more than 80% of public firms. The main differences between the two groups are the right of VCs to participate in the board of directors, the obligation of the firm to provide information about substantial matters which may affect any aspect of the business, which are situational for public VCF and standard for the private ones. The non-competition clause is rare for public firms and standard for the private ones. Moreover, the power of the VCs to force changes in the board of directors, the penalties for breach the contract, or the dateline for the VCF to complain about errors or omissions are rare for public VCF and situational for the private ones.

	Public			Private		
	Rare	Situat.	Stand.	Rare	Situat.	Stand.
Pre Investment agreements						
Control for the reliability of the information provided in the business plan (due diligence)		x			x	
Post Investment Relationship Management						
Right of VCs to participate in Bo D		x				x
Limitation on loan, transfer or advance in loan to administrators		x			x	
Non-competition clause	x					x
Managers cannot spread the own technology		x			x	
Information about substantial matters which may affect any aspect of the business		x				x
Presentation of the next budget			x			x
VC has the power to force changes in the Bo D	x				x	
It provides a compensation for breach of contract	x				x	
A dateline is fixed for the VCF to complain about errors or omissions	x				x	
Exit						
Length of contract		x			x	

Table 8. Analysis of rare, special and standard covenants for public and private VCs

According to our hypothesis, and the results provided by Isaksson et al. (2004), coercive isomorphic pressures seem to originate the heterogeneity we observe between the covenants included in the financial contract by public and private VCF. The consequence of these differences is that private venture capital companies are stricter in the application of covenants.

Discussion and conclusion

On the basis of the Institutional Theory, the central inquiry of this paper is to provide new evidence on the Spanish venture capital industry. The study is conducted by means of a survey answered by 41 Spanish venture capital firms which supply information regarding contractual arrangements used in their relationship with their portfolio companies.

In line with the findings of Isaksson et al. (2004) in Sweden, this analysis shows that a large part of the Spanish venture capital contracts are quite similar. It shows a high level of industry standardization. In this study, this is particularly obvious when we study the venture capital firms according to some characteristics, such as VCs' experience or investment preferences. However, some differences in the design of contracts between public and private venture capital firms appear due to a lower degree of isomorphism within the group of public companies. This is the result of the coercive pressures exerted by the government on them, making their behavior heterogeneous not only in relation to the industry but also within the field.

The main difference with respect to the Swedish VC contractual arrangements (Isaksson et al., 2004) is that the investment preferences have no effect on the design of contracts for the Spanish venture capital firms. However, for the Swedish case, the two groups of firms (early or later stage investors) operate in different institutional environment and, as a consequence, can be seen as two different organizational fields within the industry.

Our results contribute to shed light on the financial contracts used by venture capitalists, a field of research that has so far received little discussion in the Spanish literature. Furthermore, this paper has clear benefits for policy makers, firms, and venture capitalists. A better understanding of covenants included in venture capital contracts can help firms to understand the particular terms and restraints of VCs before providing capital. Venture capitalists can use the information from this study to better understand the contractual arrangements use in their fields. And policy makers will acknowledge the effect that their pressures have on the design of venture capital contracts and, therefore, on the efficiency of the industry when providing funds to firms.

There is however one note of caution with regard to our results. Qualitative information about venture capital firms is difficult to obtain and often has to come from survey data, like in our sample. We recognize that survey data might create potential biases and possible measurement problems (Zacharakis & Meyer, 1998). However, we consider that our sample has large enough coverage of the venture capital industry (68.33%) that, although cautiously, valid conclusions can be drawn.

Further studies could expand the scope of this research to include new variables which may affect the VC contract, such as the location of the firm or gender of the VCs from an institutional perspective.

Acknowledgment

The authors acknowledge financial support by Fundación Séneca (Project 15403/PHCS/10), and by Ministerio de Ciencia e Innovación (Project ECO2011-29080).

References

- ANUARIO ASCRI 2003 (Asociación Española de Entidades de Capital Riesgo).
- BRANDER, J.; EGAN, E.; HELLMANN, T. (2009). Government Sponsored versus Private Venture Capital: Canadian Evidence. In Lerner, J. and Shoar, A. (ed.) *International Differences in Entrepreneurship*. University of Chicago Press.
- BRUTON, G.D.; FRIED, V.H.; MANIGART, S. (2005). Institutional Influences on the Worldwide Expansion of Venture Capital. *Entrepreneurship: Theory and Practice*, 29(6): 737-760. <http://dx.doi.org/10.1111/j.1540-6520.2005.00106.x>
- BRUTON, G.D.; AHLSTROM, D.; HAN-LIN, L. (2010). Institutional Theory and Entrepreneurship: Where are we now and where do we need to move in the future? *Entrepreneurship: Theory and Practice*, 34: 421-440. <http://dx.doi.org/10.1111/j.1540-6520.2010.00390.x>
- CORNELIUS, B.; HARGREAVES, C. (1991). The Role of Covenants in Venture Capital Investment Agreements. *Working paper*. University of New England.
- CORNELIUS, B. (2005). The institutionalisation of venture capital. *Technovation*, 25(6): 599-608. <http://dx.doi.org/10.1016/j.technovation.2003.12.001>
- CUMMING, D.J.; MACINTOSH, J. (2006). Crowding Out Private Equity: Canadian Evidence. *Journal of Business Venturing*, 21: 569-609. <http://dx.doi.org/10.2139/ssrn.323821>
- DEL-PALACIO, I.; ZHANG, X.T.; SOLE, F. (2012). The capital gap for small technology companies: Public venture capital to the rescue? *Small Business Economics*, 38(3): 283-301. <http://dx.doi.org/10.1007/s11187-010-9275-6>
- DIMAGGIO, P.J.; POWELL, W.W. (1983). The iron cage revisited: institutional isomorphism and collective rationality in organizational fields. *American Sociological Review*, 48(2): 147-160. <http://dx.doi.org/10.2307/2095101>
- DIMAGGIO, P. (2001). Conclusion: The futures of business organization and paradoxes of change. In P. DiMaggio (ed.). *The twenty-first century firm*, 210-243. Princeton: Princeton University Press.

- DOH, J.P.; GUAY, T.R. (2006). Corporate Social Responsibility, Public Policy, and NGO Activism in Europe and the United States: An Institutional-Stakeholder Perspective. *Journal of Management Studies*, 43(1): 47-73. <http://dx.doi.org/10.1111/j.1467-6486.2006.00582.x>
- ELANGO, B.; FRIED, V.; HISRICH, R.; POLONCHEK, A. (1995). How Venture Capital Firms Differ. *Journal of Business Venturing*, 10(2): 157-179. [http://dx.doi.org/10.1016/0883-9026\(94\)00019-Q](http://dx.doi.org/10.1016/0883-9026(94)00019-Q)
- FRUMKIN, P.; GELASKIEWICZ, J. (2004). Institutional Isomorphism and Public Sector Organizations. *Journal of Public Administration Research and Theory*, 14(3): 283-307. <http://dx.doi.org/10.1093/jopart/muh028>
- HOFFMAN, A.J. (1999). Institutional evolution and change: Environmentalism and the US chemical industry. *Academy of Management Journal*, 42: 351-371. Available at: <http://links.jstor.org/sici?sici=0001-4273%28199908%2942%3A4%3C351%3AIEACEA%3E2.0.CO%3B2-9> <http://dx.doi.org/10.2307/257008>
- HYYTINEN, A.; TOIVANEN, O. (2003). Asymmetric Information and the Market Structure of the Venture Capital Industry. *Journal of Financial Services Research*, 23(3): 241-249. <http://dx.doi.org/10.1023/A:1024623729622>
- ISAKSSON, A.; CORNELIUS, B.; LANDSTRÖM, H.; JUNGHAGEN, S. (2004). Institutional theory and contracting in venture capital: the Swedish experience. *Venture Capital*, 6(1): 47-71. <http://dx.doi.org/10.1080/1369106042000175582>
- JENG, L.A.; WELLS, P.C. (2000). The determinants of venture capital funding: evidence across countries. *Journal of Corporate Finance*, 6: 241-289. <http://dx.doi.org/10.2139/ssrn.103948>
- JOG, V.; LAWSON, W.; RIDING, A. (1991). The Venture Capitalist/Entrepreneur Interface: Expectations, Conflicts and Contracts. *Journal of Small Business and Entrepreneurship*, 8(2): 5-20.
- KLAUSNER, M.; LITVAK, K. (2001). What Economists have taught us about Venture Capital Contracting. *Working Paper*, Stanford Law School. <http://dx.doi.org/10.2139/ssrn.280024>
- MUNARI, F.; TOSCHI, L. (2010). Assessing the impact of public venture capital programmes in the United Kingdom: do regional characteristics matter? *European Financial Management Symposium*. <http://dx.doi.org/10.2139/ssrn.1539384>
- NORTH, D.C. (1990). *Institutions, Institutional Change and Economic Performance*. New York: Cambridge University Press. <http://dx.doi.org/10.1017/CBO9780511808678>
- RUHNKA, J.C.; YOUNG, J.E. (1987). A venture capital model of the development process for new ventures. *Journal of Business Venturing*, 2: 167-184. [http://dx.doi.org/10.1016/0883-9026\(87\)90006-1](http://dx.doi.org/10.1016/0883-9026(87)90006-1)

- RUHNKA, J.C.; YOUNG, J.E. (1991). Some hypotheses about risk in venture capital investing. *Journal of Business Venturing*, 6(2): 115-133. [http://dx.doi.org/10.1016/0883-9026\(91\)90014-5](http://dx.doi.org/10.1016/0883-9026(91)90014-5)
- SCOTT, W.R. (1995). *Institutions and Organizations*. Thousand Oaks: Sage Publications.
- SUCHMAN, M.C. (1995). Localism and globalism in institutional analysis: the emergence of contractual norms in venture finance. In Scott, W. and Christensen, S., *The Institutional Construction of Organizations*. Thousand Oaks: Sage Publications.
- TYKVOVÁ, T. (2007). What do economists tell us about Venture capital contracts? *Journal of Economic Surveys*, 21(1), 65-89. <http://dx.doi.org/10.1111/j.1467-6419.2007.00272.x>
- ZACHARAKIS, A.; MEYER, G. (1998). A lack of insight: do venture capitalists really understand their own decision process? *Journal of Business Venturing*, 13: 57-76. [http://dx.doi.org/10.1016/S0883-9026\(97\)00004-9](http://dx.doi.org/10.1016/S0883-9026(97)00004-9)

Appendix A

List of VC firms for categorization (see methodology)

VC code	Created	No. investments 2003	No. employees	Firm structure	Experience group	Investment preferences
VCF 1	1999	0	11	private	inex	late
VCF 2	1988	12	60	public	exp	early
VCF 3	1997	2	6	private	inex	late
VCF 4	2000	1	8	private	inex	late
VCF 5	1991	.	73	private	exp	late
VCF 6	1989	16	9	public	exp	early
VCF 7	2000	.	1	private	inex	late
VCF 8	1992	1	.	public	inex	early
VCF 9	1986	4	12	private	exp	late
VCF 10	1984	3	6	public	exp	early
VCF 11	1988	.	3	private	exp	late
VCF 12	2000	.	1	private	inex	late
VCF 13	1987	.	4	private	inex	late
VCF 14	2000	3	.	private	inex	late
VCF 15	2001	3	4	private	inex	early
VCF 16	1990	2	1	private	inex	late
VCF 17	1999	.	4	private	inex	early
VCF 18	1992	0	7	private	inex	late
VCF 19	2000	4	12	private	inex	late
VCF 20	1999	4	.	private	inex	early
VCF 21	2000	2	3	private	inex	late
VCF 22	2000	1	8	private	inex	late
VCF 23	1982	11	8	private	exp	late
VCF 24	1999	0	19	private	inex	late

VC code	Created	No. investments 2003	No. employees	Firm structure	Experience group	Investment preferences
VCF 25	1999	3	2	private	inex	early
VCF 26	2000	2	.	private	inex	late
VCF 27	1984	11	14	public	exp	late
VCF 28	1984	6	8	public	exp	late
VCF 29	2000	13	5	private	inex	early
VCF 30	1993	0	8	private	inex	late
VCF 31	1993	5	3	public	inex	late
VCF 32	1989	7	2	private	inex	late
VCF 33	1986	2	4	private	inex	late
VCF 34	2001	8	.	private	inex	late
VCF 35	1998	5	5	private	inex	late
VCF 36	2002	11	7	private	inex	late
VCF 37	1987	6	16	private	Exp	late

The Number of investments is the total number of investments made since VC firm was established

Appendix B

List of covenants in contracts

Pre-investment agreements	
Control for the reliability of the information provided in the business plan (due diligence)	There is an agreement on an economic margin which absorb omissions in the Business Plan
Post-investment relationship management	
Limitations on contracting external advisors	Entrepreneur should refrain from transactions with intimates
Right of VCs to participate in Bo D	VCs to requests one or several places in the investee's Board of Directives
Veto rights of VCs on...	
New issue of shares	Limitations are put on purchase, subscription and sale of any company's shares
Executive's salary	Limitation on executive's salary
Important decisions	The Firm has the right of veto on some decisions
Financial Limitations	
Limitation on important expenses are established	
Limitation on the external indebttness of the company	
Limitation on loan, transfer or advance in loan to administrators	
Loyalty clause	
Non-compete clause	Non-competition clause is negotiated with managers
Managers cannot spread the own technology	Managers are obliged not to spread the own technology
Informational requirements	
Periodic presentation of accounting states	Periodic presentation of accounting states: Balance and profit and loss account
Periodic economic-financial reports	
Yearly audits	
Presentation of the next budget	The Firm has to present the budget for the next year, at

	the end of the financial year
Information about substantial matters which may affect any aspect of the business	
Veto Rights of the VCs in particular agreements	A clause is fixed which requires a favourable vote in particular agreements from the Firm's Advisors of the Venture Capital
Stand Still agreement	The manager is not allowed to sell equity
Specifics events in post-investment period	
VC has the power to force changes in the Bo D	The venture capital firm leaves open the possibility to force changes in the investee's board of directors
The VC Firm can to intervene if the objectives are not achieved	
It provides a compensation for breach of contract	
Anti-dilution ratchet	If the capital is increased, the venture capital firm has the right of preferential subscription in order to ensure it ownership of the company's security
A dateline is fixed for the firm to complain about errors or omissions	
Exit	
Timing of exit	The Firm leaves open the possible temporal reduction of its permanence in the investee
Length of contract	Contract's length is negotiated with managers

Appendix C

Analysis of rare, situational and standard covenants

	Rare	Situational	Standard
Pre-investment agreements			
Control for the reliability of the information provided in the business plan (due diligence)		x	
Post-investment relationship management			
Limitations on contracting external advisors		x	
Right of VCs to participate in Bo D			x
Veto rights of VCs on...			
New issue of shares			x
Executive's salary		x	
Important decisions			x
Financial Limitations			
Limitation on important expenses are established		x	
Limitation on the external indebtedness of the company		x	
Limitation on loan, transfer or advance in loan to administrators		x	
Loyalty clause			
Non-compete clause		x	
Managers cannot spread the own technology		x	
Informational requirements			
Periodic presentation of accounting states			x
Periodic economic-financial reports			x
Yearly audits			x
Presentation of the next budget			x
Information about substantial matters which may affect any aspect of the business			x

Veto Rights of the VCs in particular agreements			x
Stand Still agreement		x	
Specifics events in post-investment period			
VC has the power to force changes in the Bo D		x	
The VC Firm can to intervene if the objectives are not achieved		x	
It provides a compensation for breach of contract		x	
Anti-dilution ratchet		x	
A dateline is fixed for the firm to complain about errors or omissions		x	
Exit			
Timing of exit		x	
Length of contract		x	

© Intangible Capital, 2013 (www.intangiblecapital.org)



El artículo está con Reconocimiento-NoComercial 3.0 de Creative Commons. Puede copiarlo, distribuirlo y comunicarlo públicamente siempre que cite a su autor y a Intangible Capital. No lo utilice para fines comerciales. La licencia completa se puede consultar en <http://creativecommons.org/licenses/by-nc/3.0/es/>