

# **Conflicts and Regrets in the Venture Capitalist–Entrepreneur Relationship**

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*The goal of this paper is to examine whether conflicts with venture capitalists (VCs) could prompt chief executive officers (CEOs) to experience regret of action (regarding their poor partner choice) or regret of inaction (regarding their own inability to avert conflict). We argue that it is important to examine such feelings of regret that could motivate CEOs to change their financial intermediation and collaboration strategies in the future. We propose that VCs and CEOs may experience two types of conflict: (1) pacing conflicts regarding the direction and speed of venture advancement driven by perceived inequities in economic and social exchange; and (2) prerogative conflicts about the allocation of control rights and relationship issues driven by the perceived inequities in power relations. We hypothesize that pacing conflicts will be related to increasingly intense prerogative conflicts, whereas the latter will be associated with both types of CEO regret. The proposed model is tested with structural equation modeling techniques applied to the data collected from 104 CEOs of VC-backed ventures. All the hypotheses are supported. Our main finding is that CEOs appear to be ambivalent about their conflict with VCs, regretting both their prior choices as an error of judgment (regret of action) and their own lack of initiative (regret of inaction).*

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## **Introduction**

Over the years, a great number of studies have examined the types, dynamics, and causes of conflict between venture capitalists (VCs) and chief executive officers (CEOs) of their portfolio companies (Forbes, Korsgaard, and Sapienza 2010; Goldenberg and Goldenberg, 2009; Gorman and Sahlman 1989; Higashide and Birley 2002; Parhankangas and Landstrom 2004; Parhankangas and Landström 2006; Sahlman 1990; Sapienza and Korsgaard 1996; Turcan 2008; Yitshaki 2008; Zacharakis, Erikson, and George 2010). Part of this research has employed the characterizations of conflict types

developed in the intragroup conflict theory (Amason 1996; Jehn 1995, 1997; Jehn and Bendersky 2003; Jehn and Mannix 2001). Hence, VC–CEO conflicts were broken down into “cognitive” or “task” conflicts stemming from disputes about venture goals and policies, “process conflicts” arising from disagreements about the allocation of duties and rights, and “affective” or “relationship” conflicts springing from personality clashes, emotional outbursts, and perceived incompatibilities (Higashide and Birley 2002; Yitshaki 2008; Zacharakis, Erikson, and George 2010). In contrast, another research stream has focused on identifying the specific causes of VC–CEO conflicts, such as divergent

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interests and agency problems (e.g., venture valuations that benefit VCs at the expense of entrepreneurs and vice versa); control issues (both VCs and CEOs may claim that they alone should be entitled to make strategic and tactical decisions regarding the venture); perceived fairness (or lack thereof) of the existing contracts and arrangements; and behavioral issues, such as the perception that a partner had acted opportunistically often leading to reciprocal negative attributions (Forbes, Korsgaard, and Sapienza 2010; Gorman and Sahlman 1989; Parhankangas and Landström 2006; Sahlman 1990).

In this study, we build on both streams of research on VC–CEO conflict and raise a number of new questions that have been overlooked, to the best of our knowledge, in prior studies. The first question concerns the types of conflict identified in the intragroup conflict theory and whether such conflict types—cognitive (task based), process, and affective (relationship based)—adequately reflect the nature of conflicts between VCs and CEOs of their portfolio companies. The second question concerns the learning outcomes of conflict for CEOs of venture-financed companies and the effect of such learning on CEOs' financial intermediation and collaboration strategies at the time when they seek to launch a new venture. Financial intermediation strategy is related to choice of financiers for the new venture with potential candidates encompassing VCs, private investors, often described in the literature as business angels, and corporate venture capitalists (CVCs), different VC types (generalists versus specialists) (Norton and Tenenbaum 1993a, 1993b), and even government agencies such as the Small Business Administration (Craig, Jackson, and Thomson 2009). In turn, collaboration strategy may relate to choosing among different ways of improving communication and collaboration with VCs to avoid or mitigate conflict.

Answering the first question, we propose that the existing conflict typology (Amason 1996; Jehn 1995, 1997; Jehn, Rispens, and Thatcher 2010) may not be quite suitable, at least for the purposes of researching VC–CEO conflict, for several reasons. First, it is doubtful that some conflicts (cognitive or task based) lack any emotional content, whereas other conflicts (affective or relationship based) are overflowing with emotions but lacking any cognitive or task-based content. It seems more appropriate to approach different conflict types

as differing in their cognitive content and emotional intensity rather than being divorced from emotions or cognitions. Second, we believe that the intragroup conflict theory generally overlooks the important fact uncovered in research on VC–CEO conflict (Forbes, Korsgaard, and Sapienza 2010; Parhankangas and Landstrom 2004; Parhankangas and Landström 2006; Sapienza and Korsgaard 1996; Turcan 2008) that conflicts are habitually related to perceptions of fairness or unfairness (inequity) that turn simple disputes into downright conflicts. Assuming that some conflicts are limited to conceptual disagreements (cognitive or task based) and other conflicts are limited to personal problems and issues (affective or relationship based) appears unrealistic. Third, the intragroup conflict theory does not sufficiently take into account, in our view, that conflicts are related to power and control in organizations—conversely, this subject has been examined very thoroughly within exchange theory (Ford and Johnson 1998; Johnson, Ford, and Kaufman 2000; Lawler and Yoon 1993; Molm 2001, 2003; Molm, Peterson, and Takahashi 1999).

The greatest accomplishment of the intragroup conflict theory, in our view, is that it has established the existence of different and interconnected conflict types and their dynamics (Amason 1996; Jehn 1995, 1997). Furthermore, the intragroup conflict theory has appropriately focused on examining functional versus dysfunctional consequences of conflict and relating them to different conflict types (Jehn and Mannix 2001). Finally, the latest studies informed by the intragroup conflict theory have fittingly emphasized that conflict asymmetry (divergent perspectives on conflict by different parties) may contribute to conflict intensity (Jehn, Rispens, and Thatcher 2010). It is important, however, to revise the existing typology of conflict types proposed in the intragroup theory and applied to other areas of research to develop a more realistic and domain-specific approach toward VC–CEO conflict. Specifically, conflicts between VCs and CEOs of VC-backed or portfolio companies show, in our opinion, that cognitive or task-related conflicts are related to the key issues of what direction to choose for the new venture, what goals to set, and how fast such goals should be accomplished. Based on Gersick's (1994) ideas, we propose to describe such cognitive or task-based conflicts as pacing conflicts because VCs

and CEOs commonly disagree on pacing issues related to strategy, financing, and exit decisions. Although pacing conflicts are clearly cognitive in nature, they may also contain, in our view, strong emotional overtones and be influenced by perceived inequities in both economic and social exchange.

Exchange theory (Blau 1964; Emerson 1976; Hegtvedt and Killian 1999; Homans 1961; Lind and Tyler 1988) helps, in our opinion, to identify the problems in the VC–CEO relationship that may lead to various types of conflict. Such problems can arise when partners disagree as to what share of expected rewards they should receive (i.e., regarding the conditions and consequences of economic exchange) and how much effort they should put into their collaborative effort (i.e., regarding the conditions and consequences of social exchange) (Lawler and Yoon 1993; Molm, Collett, and Schaefer 2006). Furthermore, exchange theory emphasizes the impact of power and control on conflict (Ford and Johnson 1998; Hegtvedt and Killian 1999; Johnson, Ford, and Kaufman 2000; Molm, Peterson, and Takahashi 1999). Based on the exchange theory's approach toward conflict as influenced by power and control (Molm, Collett, and Schaefer 2006), we propose that process conflict and affective or relationship-based conflict identified in the intragroup conflict theory (Jehn 1995; Jehn, Rispens, and Thatcher 2010) may actually merge. Consequently, we introduce a new construct of prerogative conflicts arising between VCs and CEOs when the two parties disagree on issues of allocation of control over the venture and develop relationship issues. We argue that pacing conflicts and prerogative conflicts will be closely associated with one another as both conflict types are emotional and related to the perceived inequities of exchange.

In addition, we seek to establish what lessons CEOs may learn from their conflicts with VCs. Recent research has examined entrepreneurial experience as learning (Harrison and Leitch 2008; Sardana and Don Scott-Kemmis 2010). Prior research on VC–CEO conflicts has mostly focused on the effect of different types of conflict on venture performance (Higashide and Birley 2002; Parhankangas and Landstrom 2004; Parhankangas and Landström 2006). The question arises, though, as to what CEOs may learn from conflict and how they may adjust their financial intermediation and collaboration strategies in the wake of conflict. This subject is

important because entrepreneurs learn from experience, including failure and grief (Shepherd 2003). Learning from conflicts with VCs could teach venture CEOs how to avoid making the same mistakes in the future as they start planning for a new venture. We hypothesize that because conflict with VCs represents a highly intense and painful experience, CEOs are likely to regret both their choice of VC financing and particular VC partners (i.e., experience regret of action) as well as regret their own inertia in handling the conflict and allowing it to get out of hand (i.e., experience regret of inaction). As a result of being affected by such counterfactual emotions (Zeelenberg et al. 2006), CEOs may decide to adjust their intermediation and collaboration strategy in the future. This implies that serial entrepreneurs that start numerous ventures could benefit by learning from conflict over time.

The main contribution of this study is that it adds to our understanding of the causes, dynamics, and affective-learning outcomes of VC–CEO conflicts. We establish that pacing conflicts between VC and CEO may not be purely cognitive, cerebral disagreements but rather be related to the perceived inequities of economic and social exchange (with social exchange, playing a greater role as the antecedent of pacing conflicts). Furthermore, this study suggests that regret may actually foster new resolutions and provide the motivation to change and/or adjust future strategies. The study is based on a survey of over a hundred venture CEOs located in the United States. Structural equation modeling (SEM) analysis applied to the collected data provided support for the hypotheses.

### ***The Intragroup Conflict Theory and Research on VC–CEO Conflict***

Intragroup conflict theory contrasts (1) cognitive or task-based conflicts arising when parties disagree about the ways and means of achieving common goals or as to what strategies to pursue; (2) process conflicts that occur when parties disagree as to their roles and allocation of duties, responsibilities, and control rights in accomplishing a particular task; and (3) affective or relationship-based conflicts that emerge when parties begin to view their approaches and even personalities as incompatible and develop emotionally charged negative attributions of

one another (Amason 1996; De Dreu and Weingart 2003; Jehn 1995, 1997; Jehn and Bendersky 2003). Part of the extant research on VC–CEO conflicts has been influenced by the intragroup conflict theory and focused on examining the relationship between cognitive, task-based, process, and affective relationship-based conflicts (Higashide and Birley 2002; Yitshaki 2008; Zacharakis, Erikson, and George 2010). In contrast, other studies on VC–CEO conflict did not use the characterizations of conflict types from the intragroup conflict theory but rather focused on uncovering the specific causes of VC–CEO conflicts ranging from agency problems (Gompers and Lerner 2004; Sahlman 1990) to violations of procedural justice (Parhankangas and Landstrom 2004; Parhankangas and Landström 2006; Sapienza and Korsgaard 1996) to falling equity valuations decreasing CEOs' stake (Forbes, Korsgaard, and Sapienza 2010) to inadequate support of the venture by VCs often due to VC–CEO mismatch (Barney et al. 1996; Busenitz, Fiet, and Moesel 2004; Ehrlich et al. 1994; Perry 1988; Rosenstein et al. 1993; Smith 2001).

We believe that both research streams on VC–CEO conflict, the stream related to the intragroup conflict theory and using its categories (Higashide and Birley 2002; Yitshaki 2008; Zacharakis, Erikson, and George 2010) and the stream unrelated to the intragroup theory (Barney et al. 1996; Busenitz, Fiet, and Moesel 2004; Ehrlich et al. 1994; Gorman and Sahlman 1989; Sahlman 1990) have made some important contributions that laid the foundation of conflict theory in the area of VC–CEO collaboration. Both research streams, however, have not raised some important questions that deserve investigation to deepen our understanding of VC–CEO collaboration and ways of improving it. The first of these questions refers to conflict types observed in the VC–CEO interface. It is important, in our view, to examine the questions as to (1) whether or not conflicts between VCs and CEOs fall into recognizable types; (2) whether or not such conflict types correspond to conflict types as they are defined in the intragroup conflict theory; (3) whether such conflict types are related or exhibit certain dynamics and may have certain antecedents; and (4) whether or not CEOs (as well as VCs) draw lessons from their conflicts affecting their future strategies.

We believe that the intragroup conflict theory is correct in claiming that there are some

recognizable conflict types that may exhibit particular dynamics and consequences (Amason 1996; Jehn 1995, 1997; Jehn, Rispens, and Thatcher 2010). At the same time, we propose that the contrast between cognitive, task-based conflicts described in the intragroup conflict theory as matter-of-fact, cerebral, and devoid of emotional content and affective relationship-based conflicts described in the intragroup conflict theory as intensely emotional and personal but lacking cognitive content appears to be exaggerated and even unrealistic. It is more likely, in our view, that both conflict types have some cognitive, affective, and personal content although differ in their underlying cognitions, the degree of emotionality or affect, and the intensity of personal associations.

Furthermore, both conflict types, in our view, are likely to be related to the perceived inequities stemming from exchange relationships. It is such perceived inequities that turn disputes into conflicts. Finally, the intragroup conflict theory, in our opinion, underestimates the impact of power relationships on conflict because those that lack power are likely to experience conflict more intensely than those in power. Although recent studies in the area of intragroup conflict theory point out that conflict asymmetry (when parties diverge in their assessments of conflict intensity) may actually contribute to conflict (Jehn, Rispens, and Thatcher 2010), this recognition is insufficient. We believe that conflict is related to inequity and power relationships, and this is why it is critical to apply exchange theory toward analysis of conflict. At the same time, because exchange theory has not analyzed conflict types but rather focused on comparing the intensity of conflict in different types of exchange (Molm, Collett, and Schaefer 2006), exchange theory needs to adopt the category of conflict types and examine how such conflict types are affected by different types of exchange.

### ***The Exchange-Based Antecedents of Pricing Conflicts between VCs and CEOs***

VCs and CEOs effectively enter economic exchange when VCs buy a stake in the venture. In gist, VCs exchange their own capital or the capital of their investors—known as limited

partners—along with the implicitly promised value-added assistance to the venture, for an equity stake, information rights, and influence on venture's strategy. In addition, VCs and CEOs effectively enter social exchange as they build mutual trust and cooperation and continually interact as partners (Shepherd and Zacharakis 2001a; Zacharakis, Erikson, and George 2010). Moreover, VC and CEOs aspire to create productive or synergistic exchange (Emerson 1976) in the process of their collaboration. Productive exchange occurs when partners generate greater benefits by working jointly than separately. Studies in exchange theory contrasted negotiated or economic exchange defined as "exchanges in which actors negotiate the terms of strictly binding agreement" and reciprocal exchange "in which actors mutually reciprocate acts of individual giving, without negotiation or assurance of return" (Molm, Peterson, and Takahashi 1999, p. 129). Curiously, actors involved in negotiated exchange typically view it as being less fair than actors involved in reciprocal exchange. As a result, more intense conflicts typically erupt in negotiated than reciprocal exchange (Molm 2003; Molm, Collett, and Schaefer 2006).

Exchange theory suggests that there are two faces to exchange: cooperative and competitive (Blau 1964). The cooperative side of exchange is driven by mutual benefits that could be extracted from productive or synergistic exchange. In turn, the competitive side of exchange is driven by conflicts of interests between the parties and the fact that a greater advantage from exchange may accrue to only one of the parties, thus frustrating the other party's expectations (Blau 1964; Molm 2003; Molm, Collett, and Schaefer 2006). Theory of distributive justice establishes that fair outcomes (when results are commensurate with contributions and efforts) increase parties' perception of the fairness of transaction (Blau 1964; Adams, 1965). Similarly, the theory of procedural justice provides evidence that consistently applied procedures guaranteeing the neutrality or impartiality of the process foster trust in decision-makers or arbiters and increase parties' perception of the fairness of exchange (Lind and Tyler 1988; Thibaut and Walker 1975). In addition, exchange theory demonstrates that even though actors may benefit from negotiated exchange that establishes mutually binding agreements, such con-

tracts can also make the competitive aspects of exchange more salient, and therefore, enhance the perception of conflict (Molm 2003; Molm, Collett, and Schaefer 2006). The conflictual dimension of exchange is reinforced when the parties are not equal, that is, when "actors who have more or better alternatives than others have a power advantage that tends to produce a corresponding inequality in exchange benefits in their favor" (Molm 2003, p. 130).

For example, VCs and CEOs usually disagree as to venture valuations as CEOs argue that such venture valuations should be higher and VCs insist that venture valuations should be lower. This is a common manifestation of what other researchers have described as a contractual conflict (Parhankangas and Landstrom 2004; Parhankangas and Landström 2006). VCs and CEOs may also develop procedural conflicts, for instance, with regard to the frequency of their communication and the amount and quality of information expected to be transferred from one party to the other (Sapienza and Korsgaard 1996; Yitshaki 2008). Finally, VCs and CEOs may develop contextual conflicts regarding the degree of VCs' strategic involvement with the venture (i.e., strategic advice) and managerial involvement with the venture (i.e., interfering into its day-to-day operations) (Yitshaki 2008). Building on contextual approach toward VC-CEO conflict by taking into account the actual context of their relationship (Parhankangas and Landstrom 2004; Parhankangas and Landström 2006; Sapienza and Korsgaard 1996; Yitshaki 2008; Zacharakis, Erikson, and George 2010), we suggest that task conflicts between VCs and CEOs may be described more specifically as pacing conflicts. Thus, VC-CEO conflicts usually arise when VCs and CEOs disagree on the speed of a venture's strategic change after VCs take control, the staging of VC financing, and the speed to initial public offering (IPO) (Harris 2010; Khanin and Turel 2012).

For instance, CEOs often feel that VCs are pushing them too hard toward moving from the stage of exploration to the stage of exploitation or commercialization and profit maximization (Zacharakis, Erikson, and George 2010). At times, however, CEOs may feel conversely that VCs are trying to slow them down using the power of the wallet: for example, providing less financing than needed (Turcan 2008). VCs may also try to stage liquidity events such as acquisitions or IPOs in order to maximize the positive

effect on their other ventures and fund raising even if this means that ventures may be pushed to mature too quickly by the grandstanding VCs (Gompers, 1996). Conversely, ventures may be kept in the shadows far too long so that VCs could better time the market (Harris 2010).

Overall, prior research has shown that VCs may steer their ventures using both temporal pacing, allowing “creative, punctuational change at milestone transition points” (Gersick 1994, p. 40) and event-based pacing, that is, attending to signals “when actions can or should be initiated, corrections made, or endeavors considered complete” (Gersick 1994, p. 41). Such dual-type pacing is emblematic of VC governance. After a venture obtains VC financing, CEOs adjust their management style to the temporal and events-based patterns of strategizing mandated by VCs. Naturally, VCs’ greater equity share could give them more power and thus the ability to impose their “pacing” strategy on reluctant CEOs (Gompers and Lerner 2004; Gorman and Sahlman 1989; Sahlman 1990). CEOs may have little choice but agree with VCs even if they view their strategic initiatives as inappropriate (Turcan 2008). For this reason, VCs’ and CEOs’ perceptions of the intensity of their disputes regarding venture’s future directions may differ significantly. Specifically, whereas VCs see them in a positive light, CEOs view them in a negative light (Zacharakis, Erikson, and George 2010).

No wonder that prior studies have provided different answers to the question of the perceived impact of VC–CEO conflict on venture performance. Studies sampling VCs have established that cognitive conflicts between VCs and CEOs are perceived as having a positive impact on performance (Higashide and Birley 2002; Yitshaki 2008). Conversely, studies sampling CEOs have established that the opposite is the case (Zacharakis, Erikson, and George 2010). From the position of social exchange theory (Molm 2003; Molm, Collett, and Schaefer 2006), CEOs’ negative opinion of cognitive conflicts can be explained by that negotiated exchange and the inequality of power between the parties in the exchange relationship are likely to affect the perception of conflict outcomes.

Additionally, the less powerful party’s perception of the intensity of pacing conflicts can be affected by the relative attention paid by the more powerful ally to the venture and its management. Previous research on VC assistance to portfolio companies has established that CEOs

often have an ambiguous attitude toward VC involvement (Barney et al. 1996). For instance, some CEOs appreciate VC’s financial assistance but view other types of assistance as useless or even detrimental (Ehrlich et al. 1994). Other CEOs recognize both the value of VC financing and VCs’ assistance in establishing networking relationships but express little interest in receiving operational support (Gomez Mejia, Balkin, and Welbourne 1990). Still other CEOs may appreciate both strategic (business) advice and operational support albeit to a different degree depending on the variety of contextual factors from venture stage and degree of innovativeness to industry and CEO experience (Barney et al. 1996; Rosenstein et al. 1993; Sapienza, 1992; Sapienza and Amason, 1993; Smith 2001). Overall, VC involvement, both strategic and managerial, has been described in the literature as one of the causes of “contextual conflicts” between VCs and entrepreneurs (Yitshaki 2008).

Scholars applying social exchange theory and theory of procedural justice have argued that open and frequent communication between parties is critical for building trust in the relationship (Shepherd and Zacharakis 2001a, 2001b). Often, VCs can allocate only limited attention to the venture (Gifford 1997). Such attention, however, may be critical to collaboration success. Following the attention-based view of the firm (De Clercq, Castaner, and Belausteguigoita 2006; Ocasio 1997), allocation of attention by decision-makers may have a strong effect on performance. Hence, CEOs’ perception that VCs do not pay enough attention to the venture could make them less receptive to VCs’ guidance and advice. Just as VCs expect to receive a timely feedback from CEOs regarding venture performance (Sapienza and Korsgaard 1996), CEOs expect a certain level of attention from VCs that is implicit in the VC–CEO contract (Sahlman 1990). If VCs fail to pay sufficient attention to the venture and its management, CEOs may begin to view pacing conflicts with VCs as being more intense. Whereas VCs may see conflict as a normal friendly dispute improving strategic decisions, CEOs could view it as imposition of inappropriate strategies by actors with little knowledge of the industry in which the venture operates that fail to honor social exchange by paying sufficient attention to the venture and its governance (Ehrlich et al. 1994; Turcan 2008; Zacharakis, Erikson, and George 2010).

In sum, VCs' greater equity stake in the venture may be viewed by CEOs as excessive and undermining the fairness of the economic (negotiated) exchange with VCs. Furthermore, the greater VCs' equity stake, the greater their ability to meddle with venture governance that could lead to conflict escalation or at least further antagonize CEOs and magnify their perception of the intensity of pacing conflicts (Turcan 2008). At the same time, VCs' insufficient attention to the venture is likely to be viewed by CEOs as undermining their social (reciprocal) exchange with VCs. Although the promise of value-added assistance is only implicit and not explicit in the VC-CEO contract, it may be viewed by CEOs as a prerequisite of forming a productive, synergistic relationship. As such, insufficient attention to the venture on the part of VCs could undermine CEOs' trust in VCs as partners and their belief in the value of VCs' advice (Turcan 2008; Zacharakis, Erikson, and George 2010). Hence, venture CEOs may view VCs' strategic proposals as based on little knowledge and understanding of the venture, and moreover, as irrelevant or dictated by vested interests. Thus, both VCs' equity stake and insufficient attention to the venture may enhance CEOs' perception of the intensity of their pacing conflicts with VCs. Therefore, we predict:

*H1. The greater VC's equity share, the more intense pacing conflicts will appear to CEOs.*

*H2. The less attention VCs pay to the venture, the more intense pacing conflicts will appear to CEOs.*

### ***The Association between the Pacing and Prerogative Conflicts between VCs and CEOs***

Along with pacing conflicts, VCs and CEOs may develop prerogative conflicts. These conflicts, in our view, represent fuse process conflicts as to what each party is expected to contribute to the exchange relationship and affective (relationship) conflicts due to clashes of personalities. Prior research has contrasted process and relationship conflicts (Jehn 1997). However, this approach may be deficient as it makes relationship (affective) conflicts appear to be devoid of cognitions. Clearly, process conflicts about allocation of resources and

duties including control rights are bound to wax emotional and relate to personal issues in view of the perceived partner hostility (Boulding 1957). Hence, we propose a new category of prerogative conflicts that combine process and affective or relationship-based conflict types identified in the intragroup conflict theory. Prerogative conflicts represent a combination of process and relationship (affective) conflicts as they concern issues of control, equity, and personal problems at once. Specifically, prerogative conflicts may arise when venture CEOs object to VCs' attempts to seize control of the venture as encroachment onto the domain they are used to regard as their own turf. This is a typical process conflict as CEOs wish that VCs limited their involvement with the venture (Ehrlich et al. 1994; Zacharakis, Erikson, and George 2010) and let them do their job unencumbered by VCs. Complex in structure, prerogative conflicts may involve both clashes about the allocation of responsibilities and control of the venture and personal frictions and vendettas.

Prerogative conflicts may arise when one party approaches collaboration from the standpoint of economic exchange, whereas the other party approaches collaboration from the standpoint of social exchange. For instance, when Steve Jobs started NeXT software and asked the VC firm Kleiner Perkins Caufield & Buyers (KP) for capital, Jobs and KP had a prolonged power struggle with regard to future exit decisions: "Jobs insisted that he alone control KP's ability to 'get liquid'—to take the company public or to sell it. KP never allowed an entrepreneur to dictate those fundamental strategic calls" (Kaplan 2007, p. 69). Although Jobs pleaded with Perkins to trust him, that is, exhibited the preference for social exchange, Perkins prevailed in affirming KP's rights to determine exit choices via contract and in so doing exhibited the preference for economic exchange. Not surprisingly, conflicts about prerogatives are endemic in the VC-CEO relationship as parties argue about control and fairness issues that lead to personal clashes (Forbes et al. 2010; Turcan 2008).

As pacing conflicts intensify, VCs become more likely to use their decision-making power to impose decisions on CEOs. In turn, such interference into venture management CEOs view as their own territory may trigger prerogative conflicts. Known for their fierce independence, entrepreneurs may strongly object to

being relegated to the role of managers. Even though venture CEOs realize that VCs have the contractual right to monitor venture performance and control them, they could become frustrated about VCs' constant meddling with running the venture (Cumming and Johan 2007). CEOs may also be apprehensive about being replaced by VCs (Flamholtz 2004; Willard et al. 1992). As a result, the intensity of pacing conflicts could be associated with the intensity of prerogative conflicts. Consequently, we predict:

*H3: The higher the intensity of pacing conflicts, the more intense prerogative conflicts will appear to CEOs.*

### ***In the Wake of Conflict: Regret of Action***

Feelings of regret stem from admission that some errors of judgment, missed opportunities, or perhaps a stroke of bad luck have brought about suboptimal outcomes (Gilovich, Medvec, and Kahneman 1998; Kahneman and Miller 1986; Landman 1987). Regret is a form of counterfactual thinking or wondering counter to the facts what could have been had one acted differently (Zeelenberg 1999; Zeelenberg and Pieters 2007). Research has identified two types of regret: (1) regret of action (when making a specific choice is viewed as the cause of suboptimal results); and (2) regret of inaction (when doing nothing or not rising to the challenge is viewed as the cause of suboptimal results). Typically, regret is defined as a negative emotion because it "implies a fault in personal action: You should have done it differently, hence self-blame is a component of regret" (Roese and Summerville 2005, p. 1273). Regret may be constructive if it facilitates a corrective action: after experiencing regret about the quality of service, consumers are likely to switch to new, better providers (Zeelenberg and Pieters 1999). In fact, decision-makers are more likely to feel regret if they believe that they will have an opportunity in the future to change their prior choices. Conversely, when decision-makers do not believe that they will get a second chance, they are more likely to try and convince themselves that they are satisfied with whatever they got (Gilbert et al. 2004). Regret, therefore, is a complex emotion: it is painful and frustrating and yet its very existence shows that a person has not lost hope to do better.

Initial research on regret suggested that over-optimistic entrepreneurs are less likely to experience regret than other actors, for instance, managers (Baron 2000). However, further studies showed that entrepreneurs may regret trying to "capitalize on poor opportunities" (Markman, Balkin, and Baron 2002, p. 153) and succumbing to escalation of commitment to a losing course of action (Markman, Baron, and Balkin 2005, p. 6). In addition, entrepreneurs may experience regret if they have been too eager to secure investment and/or panicked and accepted the very first offer received from VCs (Fiet 1995). Subsequently, venture CEOs may feel unhappy with the equity share they ceded to VCs and/or with the diminishing venture valuations during the subsequent rounds of investment (Forbes, Korsgaard, and Sapienza 2010). Many VCs espouse a cynical and manipulative attitude toward entrepreneurs that has become entrenched in the system: "the 'system' of venture capital also meant knowing how to play rough with entrepreneurs—playing on their inexperience and emotions, playing founders against each other, negotiating tough prices and generous ownership stakes that in hindsight infuriated entrepreneurs" (Kaplan 1999, 2007). Understandably, entrepreneurs may experience emotional shock once they realize that they had been taken for a ride.

In addition, VC firms appear to differ both in their ability and willingness to provide assistance to ventures (Gorman and Sahlman 1989; Macmillan, Kulow, and Khoylian, 1989). Some VCs may conceive of themselves as active investors or "close trackers," whereas others prefer to take on more passive, "laissez-faire" roles (Macmillan et al., 1989). Similarly, VCs operating in different countries are known to offer varying levels of venture assistance and supervision with North American VCs emphasizing value-added, highly involved support and European VCs providing predominantly financial guidance, monitoring, and oversight of their ventures (Sapienza 1992; Sapienza, Manigart, and Vermeir 1996). Given the heterogeneity of VC types and CEOs' expectations, CEOs may regret having picked a wrong partner. More experienced CEOs may feel that they do not need as much monitoring and advice, whereas less experienced CEOs may lament a lack of support (Ehrlich et al. 1994). For this reason, venture CEOs may regret choosing a less experienced VC who is unable to provide operational support or a VC who is too focused on venture control.

Overall, there are numerous reasons why venture CEOs may regret their choice of VC. Some of them stem from economic exchange. CEOs may feel that they did not negotiate a good bargain and overpaid for VC support (Florin 2005; Hsu 2004). Others are rooted in social exchange. CEOs may believe that the quality of their interaction with VCs was inferior due to VCs' lack of attention (Gifford 1997). Still, others originate in productive exchange. CEOs may be sorry for choosing VCs that turned out to be poor partners for them instead of trying to find VCs with whom they could have developed a genuinely synergistic relationship (Perry 1988). Intense prerogative conflicts characterized in this study as a mix of process conflicts focused on the division of labor and sharing (delegation) of duties, responsibilities, and control, and relationship conflicts arising due to perceived personal incompatibility are likely to trigger intense regret of action in venture CEOs. After all, was it not CEOs' own decision to choose a particular VC? Because CEOs have no one to blame but themselves for bad choice of VC partners or for choosing VC financing over alternative forms of financial intermediation that led to the ruinous conflict, one can argue that intense prerogative conflicts combining process and relationship problems could result in intense feelings of regret about poor choices made in the past. Therefore:

*H4a: The greater the perceived intensity of VC-CEO prerogative conflicts, the greater will be the CEOs' regret of action for choosing VC financing and particular VCs as partners.*

### ***In the Wake of Conflict: Regret of Inaction***

Prior research has shown that entrepreneurs often experience regret of inaction regarding (1) missed opportunities due to fear of failure/ridicule; (2) not starting a business by 40; (3) venturing out with others; (4) not going into business for themselves; and (5) failing to patent important inventions (Markman, Baron, and Balkin 2005, p. 19). Given that entrepreneurs are prone to experience regret about failing to act in a situation where action was appropriate or even imperative, it is possible to hypothesize that venture CEOs may regret letting their conflicts with VCs get out of hand

or failing to utilize conflict management. Emotions can be divided into backward looking, that is, responses to outcomes received in a relationship (satisfaction, anger, and resentment) and forward looking (Hegtvedt 1990; Lawler and Yoon 1993; Molm 1991). For instance, worry and excitement are forward looking. Though these emotions are related to the past, they also represent anticipation of superior strategies and tactics that could be used to improve the results (Johnson, Ford, and Kaufman 2000). Regret is a mix of backward-looking emotions such as feeling sorry about certain acts or failure to act and forward-looking emotions driven by the intent to modify and improve earlier, inappropriate choices. Such fusion of backward-looking and forward-looking emotions is what can make regret effective as a mechanism of behavior regulation (Roese, Summerville, and Fessel 2007).

In the wake of conflict, CEOs may reexamine their own inaction such as failing to use conflict avoidance and reduction strategies (Boulding 1957) that might have prevented conflict eruption and escalation. For instance, venture CEOs have direct access to information that VC needs to better understand what is happening to the venture. Whenever CEOs fail to report or underreport some critical information or stonewall VCs' directives, such conduct may aggravate VC-CEO conflict (Sapienza 1989; Sapienza and Korsgaard 1996). Feeling that CEOs are not living up to their contractual obligations, VCs are likely to replace CEOs (Bruton, Fried, and Hisrich 1997, 2000; Khanin et al. 2009). Even if CEOs stay, VCs may take control of venture management which could, in turn, exacerbate prerogative conflicts. To prevent conflict escalation or the eruption of prerogative conflicts, CEOs could benefit from acting proactively and cooperatively in order to improve their rapport with VCs and open up communication channels with VCs in the future. In this sense, giving up control paradoxically means regaining control (Sapienza and Korsgaard 1996). However, if CEOs succumb to feelings of anger and frustration, they could later regret their own passivity or refusal to act more collaboratively and try and find a common ground with their interorganizational allies. Hence, prerogative conflicts may trigger regret of inaction when CEOs feel the conflict could have been mitigated had they acted proactively to do so.

**Table 1**  
**Demographic Characteristics of the Respondents and**  
**Their Companies<sup>a</sup>**

Variable	Mean	Standard Deviation	Minimum	Maximum
Age	45.23	6.17	33	65
Years of Professional Experience	22.23	5.20	10	40
Years of Industry Experience	15.11	6.87	3	38
Years of Experience with the Technology	7.66	8.48	2	38
Years with the Same Team	3.14	1.19	1	7
Number of Prior Ventures Launched	2.60	3.90	0	20
Growth Rate (percent)	22.31	143.04	0	1000
Percentage of Equity Owned by Lead VC	30.88	11.59	16	70
Number of Employees	65.43	54.08	0	300

<sup>a</sup>VC, venture capitalist.

*H4b: The greater the intensity of VC-CEO prerogative conflicts, the greater will be the CEO's regret of inaction for failing to prevent conflict eruption and escalation via cooperative behavior.*

## Methods

### Procedure and Sample

We began with downloading the entire population of California ventures that have received VC assistance from 2000 to 2007 from Venture Xpert, a database of entrepreneurial ventures and VC firms maintained by Thompson Financial. Subsequently, we sent an invitation to 750 companies in the neighboring counties to take part in the survey. One hundred six CEOs agreed to participate. Once two incomplete records were removed, a sample of 104 records was retained. The characteristics of CEOs and their ventures are reported in Table 1. There appears to be a great variability in the sample in terms of growth rate and size (e.g., number of employees). The potential effects of this variability are examined in the data analysis section. The findings of this study should be interpreted with caution as they refer to a wide cross-section of VC-supported firms.

### Survey

In order to test the hypotheses, several measures were developed encompassing various manifestations of the constructs of interest

mentioned in the literature. The measures were presented to several academics and practitioners and then refined following their suggestions. Though initially some questions referred both to the lead VC and to non-lead VCs, only lead VC-related questions were retained for data analysis because CEOs indicated that non-lead VC support was less relevant. All multiple-item questions pertaining to latent variables used a Likert-type scale ranging from 1 (highly disagree) to 7 (highly agree). The percentage of equity owned was an open-ended numerical question. The resultant measurement instrument is presented in Table 2.

### Data Analysis

Our sample (just over a hundred participants) is relatively small. However, it is quite sufficient for SEM analyses. In fact, even analyses performed on much smaller samples (hovering around 50 participants) tend to generate reasonably high rates of proper solutions with acceptably low non-convergence rates (Fan, Thompson, and Wang 1999). Moreover, the comparative fit index (CFI) and the root mean square error of approximation (RMSEA) are relatively insensitive to sample sizes. In fact, sample size explains less than 1 percent of the variation in these fit statistics (Fan, Thompson, and Wang 1999). To alleviate any concerns regarding the sample size, a minimum sample size was calculated for obtaining power of 0.90 (with  $\epsilon = 0.10$ ) for RMSEA for a model with 97

**Table 2**  
**The Measurement Instrument<sup>a</sup>**

Construct	Items	Text
Regret of Action	RC1	Your venture would be better off had you avoided getting involved with VCs.
	RC2	Your venture would be better off had you chosen VCs more carefully.
	RC3	Your venture would be better off had you selected more experienced VCs.
	RC4	Your venture would be better off had you worked with VCs who had more operational experience.
Regret of Inaction	RO1	Your venture would be better off had you have been more proactive in building your relationship with the VC/s.
	RO2	Your venture would be better off had you have worked more actively on resolving conflicts and disagreements with the VC/s.
	RO3	Your venture would be better off had you have been more attentive to the VC/s' requests.
Prerogative Conflicts	PRC1	Our discrepancies with VCs concerned mostly fairness issues.
	PRC2	Our discrepancies with VCs concerned mostly control issues.
	PRC3	Our discrepancies with VCs concerned mostly relationship issues.
Pacing Conflicts	PAC1	Our discrepancies with VCs concerned mostly strategic decisions.
	PAC2	Our discrepancies with VCs concerned mostly exit decisions.
	PAC3	Our discrepancies with VCs concerned mostly financing decisions.
Perceived Lack of Attention	PLA1	We feel that the VC/s have not spent enough time on site.
	PLA2	We feel that the VC/s have not spent enough time answering our questions.
Percentage Equity Owned by Lead VC	PE1	Percentage of the venture that is owned by the lead VC?

<sup>a</sup>PAC, pacing conflicts; PE, percentage equity owned by lead VC; PLA, perceived lack of attention; PRC, prerogative conflicts; RA, regret of action; RI, regret of inaction; VC, venture capitalist.

degrees of freedom, using the critical noncentrality parameters and formulas specified by Kim (2005). Under these conditions, we would need a sample of about 52 to obtain the needed power to be able to make correct decision using the RMSEA. The sample used in this study is actually twice as large and as such adequate for SEM analyses. Still, caution needs to be exercised when interpreting the results, and close attention should be paid, especially to the CFI and RMSEA fit indices.

Subsequently, we performed reliability assessment. The Cronbach's alphas for almost all constructs exceeded the commonly used cutoff of 0.7. These results exceeding cutoff levels confirmed reasonable consistency and reliability of the sample. The Cronbach's alpha for pacing conflict was slightly below the 0.7 threshold. However, it was acceptable for two reasons. First, it has been argued that for few-item scales, such as the three-item scale used here, a coefficient alpha of 0.60 (Cortina 1993)

or even 0.50 (Nunnally and Bernstein 1994) is acceptable as a minimum standard. Second, removing items could not have increased the alpha for this construct. Consequently, all items for this construct were retained. Overall, it was concluded that constructs are sufficiently consistent and reliable, and that they have ample variation for statistical modeling (Table 3).

In addition, the potential effects of firm type on responses were examined with multivariate analysis of variance, using SPSS 19 (SPSS, Inc., Chicago, IL, USA). In this model, the measures were included as dependent variables, and number of employees and growth rate were included as covariates. Pillai's trace scores of 0.92 for number of employees ( $F[5,1] = 2.20$ ,  $p < .47$ ) and 0.69 for venture growth rate ( $F[5,1] = 0.45$ ,  $p < .81$ ) indicated that these variables were not associated with the model's measures. Hence, and given the relatively small sample size, they were not included in the SEM analysis.

Next, a confirmatory factor analysis (CFA) model was specified and estimated, as the first-step in the Anderson and Gerbing's procedure (Anderson and Gerbing 1988), using the SEM facilities of AMOS (SPSS, Chicago, USA). The model included the six constructs that were allowed to freely correlate with one another. As can be seen from Table 4, the fit statistics for this model were adequate and met the recommended cutoff values. Particularly, CFI and incremental fit index (IFI) values of over 0.95, combined with RMSEA below 0.08, indicated good fit as per the combine -fit criteria specified by Hu and Bentler (1999). The RMSEA in our case is significantly below 0.05 ( $p$ -close = .58), which further indicates an excellent fit. In addition, the model passed all the condition 9 tests (Kelloway 1998, pp. 28–29) because all the factor loadings were significant at  $p < .001$ .

Given the support received by the CFA model, it was concluded that it is plausible to assess the structural model. The structural model was specified and estimated using the same procedure. The fit statistics for this model are also outlined in Table 4. As can be seen, the model has an adequate fit, as the fit indices meet the abovementioned criteria (CFI and IFI > 0.95, RMSEA < 0.05, factor loadings significant at  $p < .001$ ). The model, standardized path coefficients, and their levels of significance, correlations, and variance explained in endogenous constructs (squared multiple correlations) are depicted in Figure 1.

**Table 3**  
**Constructs' Descriptive Statistics, Reliabilities, and Correlations<sup>a</sup>**

	Mean	Standard Deviation	Range of Item-to-Total Correlations	(1)	(2)	(3)	(4)	(5)	(6)
(1) Regret of Action	4.49	1.75	0.57–0.81	<b>0.87</b>					
(2) Regret of Inaction	4.63	1.68	0.79–0.85	0.54**	<b>0.90</b>				
(3) Prerogative Conflict	4.60	1.65	0.76–0.84	0.46**	0.49**	<b>0.89</b>			
(4) Pacing Conflict	4.28	1.34	0.43–0.50	0.54**	0.38**	0.66**	<b>0.68</b>		
(5) Perceived Lack of Lead VC's Attention	5.19	1.75	0.66–0.66	0.49**	0.38**	0.35**	0.35**	<b>0.79</b>	
(6) Percentage Equity Owned by Lead VC	33.82	19.41	NA	0.13	0.05	0.16	0.13	0.03	—

<sup>a</sup>NA, not applicable; VC, venture capitalist.

\*\* $p < .05$

\*\*\* $p < .01$

Bold indicates reliability scores (Cronbach's Alphas).

**Table 4**  
**Fit Indices for the CFA and Structural Models<sup>a</sup>**

	$\chi^2$	df	P-value	$\chi^2/df$	IFI	TLI	CFI	AIC	SRMR	RMSEA	P-close
CFA Model (Step 1)	109.2	90	0.08	1.21	0.98	0.97	0.98	201.86	0.055	0.045	0.58
Research Model (Step 2)	131.2	98	0.01	1.34	0.96	0.95	0.96	207.17	0.090	0.057	0.31

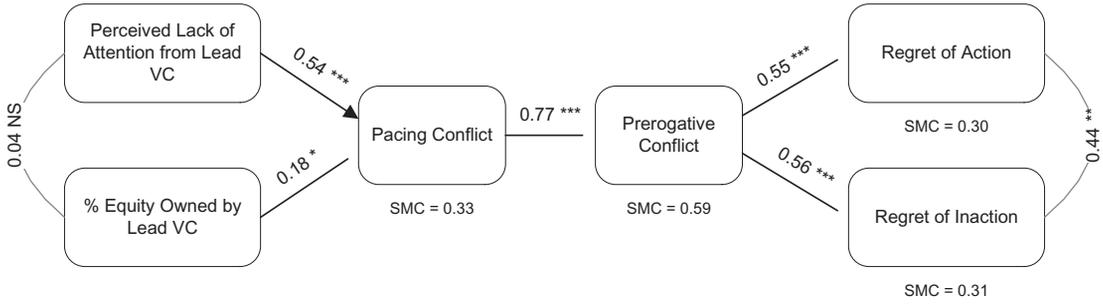
<sup>a</sup>AIC, Akaike information criterion; CFA, confirmatory factor analysis; CFI, comparative fit index; df, degrees of freedom; IFI, incremental fit index; RMSEA, root mean square error of approximation; SRMR, standardized root mean square residual; TLI, Tucker Lewis index.

## **Results**

As our analysis demonstrates, both H1 and H2 received support although to a different degree. According to H1, pacing conflicts between VCs and CEOs may be related to the lead VCs' equity share. Although H1 received only marginal support ( $p < .1$ ), the results confirm findings from prior research indicating that CEOs' shrinking equity share (and respectively, VCs' growing equity share) may serve as the antecedent of VC-CEO conflicts (Forbes, Korsgaard, and Sapienza 2010). The fact that our results are not as strong as those observed in prior studies could be explained by that previous studies had a greater share of ventures that experienced "down" rounds of investment. In such situations, CEOs' equity share typically takes a nosedive exacerbating VC-CEO conflict. Our sample may contain more ventures that have not suffered a significant loss of CEO equity due to poor performance. Hence, the observed association between VC's equity share and pacing conflict was weaker. It is clear, though, that VC-CEO conflict could be more intense if CEOs view the lead VC's equity as disproportionately large. The fact that VCs' equity share is related to CEOs' perception of conflict indicates that pacing conflicts are not merely cognitive, that is, related to disagreements on particular issues, but also affective and related to the perceived inequities of economic or negotiated exchange (Molm, Collett, and Schaefer 2006) because unfair allocation of equity stakes in the venture may certainly cause negative feelings.

At the same time, it is important to keep in mind that H2 received stronger support than H1 ( $p < .001$  versus  $p < .1$ ). This indicates that the perceived inequities social exchange measured by CEOs' belief that VCs may not have paid enough attention to the venture can serve as a stronger predictor of pacing conflicts between VCs and CEOs than the perceived inequities in economic exchange measured by CEO's belief that VCs may have seized an exorbitant equity stake in the venture. Together, the perceived problems in economic and social exchange explained 33 percent of the variation in the pacing conflict. Thus, the effect of exchange problems on pacing conflict is considerable. In addition, we observed a nonsignificant correlation between the two exogenous constructs representing economic versus social exchange. This indicates that the perceived lack

**Figure 1**  
**Standardized Parameter Estimates for the Structural Model**



**\* $p < .1$ ; \*\* $p < .01$ ; \*\*\* $p < .001$ . NS, not significant; SMC, squared multiple correlation; VC, venture capitalist.**

of VC attention to the venture varied independently of the percent of equity owned by the lead VC. That is, even if only a small percentage of the equity was owned by the lead VC, a CEO could still perceive pacing conflicts as more intense when VC failed to pay sufficient attention to the venture.

H3 received significant support ( $p < .001$ ). As hypothesized in the study, the perceived intensity of pacing conflicts was strongly associated with the perceived intensity of prerogative conflicts. The association explained 59 percent of the variation in the prerogative conflict. This indicates that pacing conflicts linked to deficiencies in economic and social exchange may be followed by territorial, that is, “turf” conflicts as to what party is entitled to control what part of venture’s activities that transcend into collisions over personal issues. The existence of a special type of prerogative conflicts provides evidence that process conflicts regarding the allocation of duties, responsibilities, and control rights (Zacharakis, Erikson, and George 2010) may actually fuse with relationship (affective) conflicts rather than coexist as two separate conflict types as previously believed (Jehn 1997; Yitshaki 2008). Furthermore, if both pacing and prerogative conflicts contain emotional overtones, we may describe conflicts as emotionally escalating instead of contrasting them as either devoid of emotional content (cognitive conflicts) or overflowing with emotion (affective conflicts). At least, we have observed a strong association between pacing and prerogative

conflicts, and both conflict types can be related to perceived unfairness of types of exchange.

H4a and H4b posited, respectively, that prerogative conflicts will be associated with two types of regret—(1) regret of action about CEOs’ previous choices of VC backing as opposed to alternative forms of financing (e.g., by business angels) and regret of action about choosing particular VCs that may not have been a better match for the CEO; and (2) regret of inaction about CEOs’ failure to avoid or mitigate conflict with VCs or prevent conflict escalation. Both hypotheses were supported at  $p < .001$ . The prerogative conflict explained 30 percent of the variation in regret of action and 31 percent of the variation in regret of inaction. Thus, this study provides evidence that prerogative conflicts are likely to be associated with strong emotional reactions on the part of CEOs reproaching themselves for the errors of judgment as well as the failure to act proactively to avoid and/or mitigate conflict preventing its escalation. Such strong counterfactual emotions related to prerogative conflict could prompt intense learning and adjustment of future strategies.

### **Discussion**

In this study, we have argued that there are two main types of VC–CEO conflicts: (1) pacing conflicts about the direction and speed of venture advancement and (2) prerogative conflicts about the allocation of control rights and personal issues. Pacing conflicts are reminiscent of task or cognitive conflicts and prerogative conflicts are reminiscent of both process

conflicts and relationship or affective conflicts identified in the intragroup conflict theory (Amason 1996; Jehn 1995, 1997; Jehn, Rispens, and Thatcher 2010). We have characterized, however, pacing and prerogative conflicts differently in comparison to how cognitive (task), process, and affective (relationship) conflicts are defined in the intragroup conflict theory. Thus, whereas the intragroup conflict theory describes cognitive or task conflicts as devoid of emotional and personal overtones and limited to strategic and operational issues at hand, we have argued that pacing conflicts may have both emotional and personal overtones and be associated with perceived inequities in economic and social exchange. Subsequently, we have shown that pacing conflicts have their antecedents in the perceived inequity of economic exchange: VCs' greater equity than would seem fair and social exchange: VCs' failure to live up to their obligations that are not explicitly stated in the contract (Sahlman 1990) but rather implicit—to provide assistance to the venture.

Similarly, our characterization of prerogative conflicts is different from the definition of either process or affective (relationship) conflicts developed in the intragroup conflict theory. We have proposed that, unlike affective (relationship) conflicts, prerogative conflicts cannot be reduced to purely emotional and personal reactions but rather are based in particular cognitions related to what parties believe to be equitable distribution of rights, duties, and responsibilities in the relationship. At the same time, unlike process conflicts, prerogative conflicts do include concerns about personal issues and incompatibilities. Thus, prerogative conflicts introduced in this study fuse process and affective (relationship) conflicts as they defined in the intragroup conflict theory. Furthermore, such conflicts reflect, as we have suggested, the perceived inequities in power relationships between the allies. In addition, we have demonstrated that pacing and prerogative conflicts are closely related. Furthermore, the explanation of the relatedness of pacing and cognitive conflicts offered in this study is quite different from the explanation of the relatedness of cognitive (task) and affective (relationship) conflicts developed in the intragroup conflict theory. The intragroup conflict theory suggests that as cognitive conflicts intensify, they take a deeply emotional and personal meaning (Amason 1996; Jehn 1995, 1997; Jehn,

Rispens, and Thatcher 2010). In contrast, we have argued that unresolved pacing conflicts are likely to lead to more aggression on the part of a more powerful party (VCs) encroaching further on the sphere of influence of the less powerful party (CEOs), which incites prerogative conflicts.

The fact that these dynamics of conflict development take place in reality has received abundant evidence coming from the research stream on VC–CEO conflict that had focused on identifying the causes of VC–CEO conflict without involving the concept of conflict types and dynamics developed in the intragroup conflict theory (Barney et al. 1996; Busenitz, Fiet, and Moesel 2004; Forbes, Korsgaard, and Sapienza 2010; Gorman and Sahlman 1989; Parhankangas and Landstrom 2004; Parhankangas and Landström 2006; Sahlman 1990; Turcan 2008). This research stream has shown that VCs as more powerful players seek to establish their control over CEOs' territory even though CEOs believe that such interference on the part of VCs is damaging and could hurt the venture due to VCs' insufficient competence (Cumming and Johan 2007, 2010; Kanniainen and Keuschnigg 2003, 2004).

Similar to recent studies (Forbes, Korsgaard, and Sapienza 2010; Zacharakis, Erikson, and George 2010), we have focused on the entrepreneur's side of the story, that is, the perception of conflict intensity by venture CEOs. Such focus on the entrepreneur can be explained first of all by that VCs' perception of the conflict and its consequences had been investigated in earlier studies (Higashide and Birley 2002; Parhankangas and Landstrom 2004; Parhankangas and Landström 2006). In contrast, much less attention has been paid in the literature to CEOs' view of conflict and its sources, and only several recent studies began closing this gap (Zacharakis, Erikson, and George 2010). In addition, VCs' and CEOs' perceptions of conflict intensity are bound to be asymmetrical. Specifically, CEOs are more likely to view their conflict with VCs as more intense due to VCs' dominant position in the relationship (Zacharakis, Erikson, and George 2010) and VCs' often observed aggressive conduct toward venture CEOs (Parhankangas and Landstrom 2004; Parhankangas and Landström 2006; Turcan 2008). Finally, asymmetric conflicts, with parties to the conflict diverging in their view of conflict intensity, are especially likely to escalate and result in

negative outcomes (Jehn, Rispens, and Thatcher 2010).

Whereas prior research on VC–CEO conflict has focused on the perceived effect of conflict on venture performance (Higashide and Birley 2002; Yitshaki 2008), we raised the question, overlooked, in our view, in prior research on VC–CEO conflict as to how CEOs' perception of conflict intensity, specifically their reaction to the most divisive, prerogative conflicts, may affect CEOs' future strategies of financial intermediation and collaboration. Based on the literature on regret as a counterfactual emotion (Roese and Summerville 2005; Roese, Summerville, and Fessel 2007; Zeelenberg 1999; Zeelenberg, Inman, and Pieters 2001; Zeelenberg et al. 2006), we proposed that CEOs may experience both regret of action and regret of inaction—two forward-looking emotions providing the motivation for behavior change. Our findings confirm that CEOs experience both types of regret that are steering CEOs in different directions. Regret of inaction about choosing VC financing over other types of financing or choosing particular VCs over better partners appears to push VCs toward changing their financial intermediation strategy by choosing different and potentially less expensive forms of financing, with less strings attached (such as financing by business angels and CVCs) and/or choosing better VC partners by undertaking more thorough search of VC candidates. Conversely, regret of inaction seemingly pushes VCs toward retaining their previous choice of VC financing as the most appropriate alternative but change instead their own collaboration strategy. By using a more accommodating conflict management strategy, CEOs may avoid conflict eruption and escalation and prevent pacing conflicts from inciting prerogative conflicts.

Our key findings are as follows. First, we have established that pacing conflicts between VCs and CEOs have their antecedents in the perceived inequities of economic and social exchange. Second, we have shown that, based on our analysis, social exchange has a stronger association with pacing conflicts compared with economic exchange. We have argued that such weak association of economic exchange (specifically, of the lead VC's equity share) with pacing conflicts can be explained by that CEOs are likely to view lead VC's equity share as disproportionately high following the down rounds of investment decimating their equity in

the venture (Forbes, Korsgaard, and Sapienza 2010). Because our sample probably contains a fewer number of ventures whose CEOs have suffered a considerable loss of equity, the association between VCs' equity share and conflict we observed was respectively weaker than in previous studies (Forbes, Korsgaard, and Sapienza 2010). In contrast, the association between inequities in social exchange (VCs not paying enough attention to the venture) and conflict was strong. This confirms prior findings indicating that VCs often fail to pay attention to the venture (Gifford 1997; Kannianen and Keuschnigg 2003, 2004). The fact that the perceived inequities of social exchange are important is illustrated by VCs' and CEOs' contrasting approaches toward their investment in the venture. Specifically, VCs tend to determine the duration of their investment in the venture on rational grounds: VCs “exit when the expected marginal cost of maintaining the investment is greater than the expected marginal benefit” (Cumming and Johan 2010, p. 228). In contrast, CEOs tend to approach the venture as their brainchild and may view the failure of VCs to commit to the venture as being opportunistic.

Our second finding is that there is a strong association between the intensity of pacing and prerogative conflicts between VCs and CEOs. Prior research has shown that task or cognitive conflicts and relationship or affective conflicts between VCs and CEOs are often interrelated (Higashide and Birley 2002). Pacing and prerogative conflicts, however, as they are defined in this study are different from task (cognitive) and relationship (affective) conflicts as they are defined in the intragroup conflict theory. This is why our finding that these two conflict types are closely related is not trivial. We theorize the existence of such association on different grounds compared with the intragroup conflict theory. The latter suggests that cognitive or task conflicts can get increasingly personal and emotional and thus turn into affective or relationship conflicts. In contrast, we suggest that increasingly intense pacing conflicts could instigate power struggle leading to prerogative conflicts focused on the allocation of control rights among the parties.

The third finding of this study is that CEOs, as hypothesized, experience strong feelings of regret in the wake of conflict. These feelings of regret, however, are ambivalent as CEOs both regret their choices, viewing them as an

error of judgment (regret of action) and regret their own lack of initiative (regret of inaction). These two types of regret may lead, respectively, to change in financial intermediation strategy (regret of action) and change in collaboration strategy (regret of inaction). The fact that entrepreneur regret may play such an import role in the process of entrepreneurial learning, in our view, is very important and deserves additional investigation in the future. For instance, the learning potential of regret could explain the advantage of serial entrepreneurs pushed by regret of action and inaction to modify and adjust their future strategies.

### **Limitations and Future Directions**

This study has some limitations. First limitation has to do with the fact that our entire sample is U.S. based. VC–CEO conflicts in other countries may be ingrained in a different cultural–historic context and, therefore, applying our findings to other countries than the United States should be done with caution, taking into account the potential cultural discrepancies. Second, our sample size—just above 100 respondents—is somewhat small although it was sufficient for performing SEM analysis. Nevertheless, a larger sample would probably provide a richer and more detailed picture of the VC–CEO conflict and lead to new discoveries. Although we have conducted a number of interviews with the respondents, the study could probably benefit from including a more substantial qualitative, content analysis of CEOs’ and VCs’ outlook on their conflict.

Future researchers may want to further investigate whether or not process–relationship conflicts represent, indeed, a distinct conflict rather than two separate conflict types as previously thought (Jehn 1997; Zacharakis, Erikson, and George 2010). Given the importance of this conclusion, it could be examined within different vistas of research within entrepreneurship literature and conflict studies. Future scholars may also consider reexamining the existence of pacing conflicts in the VC–CEO relationship and seek to identify other types of contextual conflicts between VCs and CEOs. Finally, more studies are needed on the nature of entrepreneur regret. We know that entrepreneurs actually are prone to experience regret, possibly more than ordinary managers (Markman, Balkin, and Baron 2002; Markman, Baron, and Balkin 2005). However, it is impor-

tant to further delve into the positive and negative aspects of entrepreneur regret and how they may affect the VC–CEO conflict.

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