ENTREPRENEUR-VENTURE CAPITALIST ALLIANCES AS EXTERNALIZATION-INTERNALIZATION DECISIONS (SUMMARY)

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Principal Topic

Transaction cost economics (TCE) suggests that businesses continually compare the benefits and costs of hierarchies or internalization (the make decision) vs. the benefits and costs of markets or externalization (the buy decision) (Williamson, 1975; 1985). From the TCE perspective, alliances represent a hybrid of markets and hierarchies (Williamson, 1991). TCE is rarely applied to entrepreneurship (Zacharakis, 1997; Michaels, 2007). We propose that venture capitalist-entrepreneur alliances could fruitfully be examined from the TCE perspective as a specific type of hybrids. Specifically, we argue that venture CEOs’ assessment of the value of alliances with VCs will be influenced by the perceived benefits of externalization and internalization, separately and in combination, as well as the sum of transaction costs and administrative costs incurred by new venture.

Theory Development: Key Propositions

Hypothesis 1: The perceived benefits of externalization through VC involvement will be positively associated by venture CEOs with the combined benefits of externalization and internalization.
Hypothesis 2: The perceived benefits of internalization through VC involvement will be positively associated by venture CEOs with the combined benefits of externalization and internalization.
Hypothesis 3: The perceived benefits of externalization through VC involvement will be positively associated by venture CEOs with the incurred combination of transaction costs and administrative costs.
Hypothesis 4: The perceived benefits of internalization through VC involvement will be positively associated by venture CEOs with the incurred combination of transaction costs and administrative costs.
Hypothesis 5: The combined benefits of externalization and internalization and the combined transaction costs and administrative costs will be positively (negatively) associated by venture CEOs with the overall value of their alliances with VCs.

Methods

We surveyed over 100 CEOs of new ventures regarding their assessments of the value of VC-entrepreneur alliances. Structural equation modeling (SEM analysis) was used to analyze the data.

Findings

All the proposed hypotheses received strong support.

Practical Implications

Venture CEOs need to realize the dual nature of VC-entrepreneur alliances that represent a unique combination of externalization and internalization to be able to improve the efficacy of their collaboration with VCs by reducing both the transaction costs and administrative costs of VC involvement.

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