HOW SHOULD WE DIVIDE THE PIE? 
PERCEIVED JUSTICE OF EQUITY DISTRIBUTION AND ITS IMPACT ON ENTREPRENEURIAL TEAM INTERACTIONS AND OUTCOMES

Nicola Breugst 
Technische Universität München, Germany, nicola breugst@tum.de

Philipp Rathgeber 
Technische Universität München, Germany

Sven Kleinknecht 
Technische Universität München, Germany

Recommended Citation
Breugst, Nicola; Rathgeber, Philipp; and Kleinknecht, Sven (2014) "HOW SHOULD WE DIVIDE THE PIE? PERCEIVED JUSTICE OF EQUITY DISTRIBUTION AND ITS IMPACT ON ENTREPRENEURIAL TEAM INTERACTIONS AND OUTCOMES," Frontiers of Entrepreneurship Research: Vol. 34: Iss. 9, Article 1.
Available at: http://digitalknowledge.babson.edu/fer/vol34/iss9/1
Abstract

Drawing on a longitudinal multiple case study approach and data on eight entrepreneurial teams this article develops a dynamic model of the consequences of equity distribution among team members. Perceived justice of equity distribution emerged as a key variable influencing entrepreneurial team interactions. High perceived justice triggered positive team interaction spirals, whereas low perceived justice triggered negative interaction spirals. Teams exposed to external erosive stressors drifted from a positive spiral to a negative spiral despite high perceived justice. These spirals impacted important entrepreneurial outcomes. We discuss the implications of our study for research on entrepreneurial imprinting, justice, and exit.

Introduction

Anecdotal evidence suggests that the distribution of equity among co-founders is a far-reaching, emotionally-laden decision for entrepreneurial teams (Wasserman, 2012). This is hardly surprising, given that equity ownership represents the primary economic reward entrepreneurs receive (Hall & Woodward, 2010) and equity is connected to the entrepreneurs’ control over their firm (Nelson, 2003). However, there has been a remarkable paucity of studies on this topic (Hellmann & Wasserman, 2011). This is surprising given the substantial interest to understand how entrepreneurs’ decisions made at venture foundation imprint its future development (Beckman & Burton, 2008; Beckman, Burton, & O’Reilly, 2007). While there has been some recent work on the drivers and processes of equity distribution (Kotha & George, 2012), so far few studies have analyzed the consequences of this distribution by focusing on financial venture outcomes only (Hellmann & Wasserman, 2011; Kroll, Walters, & Le, 2007). However, we know little about the consequences of equity distribution for the social interaction within entrepreneurial teams and, in turn, outcomes of these interactions, such as team stability and team/venture performance. Investigating these interactions and outcomes will help to better understand how entrepreneurial teams impact venture development and performance.

Given that no comprehensive understanding of the consequences of equity distribution in entrepreneurial teams exists so far, field-work and grounded-theory “is more likely to generate novel and accurate insights into the phenomenon under study than reliance on either past research or office-bound thought experiments” (Brown & Eisenhardt, 1997, p. 2). Thus, we relied on a longitudinal multiple case study approach drawing on eight entrepreneurial teams which we interviewed and followed over a period of six months.
Our study provides several major new insights. First, current research has neglected the impact of equity distribution on social interactions within the entrepreneurial team. From our data emerged clear patterns how team members’ perceived justice of equity distribution imprints the entrepreneurial team’s social interactions. High perceived justice triggered a reciprocal, positive team interaction spiral which consisted of an increase in team attraction and a decrease in team repulsion over time. Low perceived justice resulted in a reciprocal, negative team interaction spiral consisting of a decrease in attraction and an increase in repulsion. Triggered by external erosive stressors, some teams initially high in perceived justice could not maintain the positive interaction spiral over time but started drifting into a negative spiral. The two interaction spirals affected important entrepreneurial outcomes: team stability as well as team and venture performance. Second, we contribute to the literature on justice in organizational contexts. In contrast to employees in established firms, all entrepreneurial team members are typically involved in the decision on equity distribution (Hellmann & Wasserman, 2011). Despite this involvement, our study highlights substantial variance in perceived distributive justice across teams and within teams over time. Perceptions of justice appear to play an important role in the development of the team and the venture. Finally, an emerging literature studying the reasons and routes of entrepreneurial exit has identified a variety of drivers for exit decisions (e.g., Bruton, Fried, & Hisrich, 2000; Gimeno, Folta, Cooper, & Woo, 1997; Ucbasaran, Lockett, Wright, & Westhead, 2003; Wennberg, Wiklund, DeTienne, & Cardon, 2010). Our model extends the theories on entrepreneurial exit by incorporating dynamic interaction spirals within the entrepreneurial team which are influenced by the team members’ perceptions of just or unjust equity distributions, and which, in turn, influence team member exit.

Theoretical Context

Entrepreneurial teams are “two or more individuals who have a significant financial interest and participate actively in the development of the enterprise” (Cooney, 2005, p. 229). Entrepreneurial teams differ from corporate management teams because they lack the context of an established organization resulting in unclear internal structures (Blatt, 2009). They also own a substantial part of the venture’s equity and thus carry a significant proportion of the venture’s risk (Hall & Woodward, 2010). However, they enjoy more freedom regarding strategy formulation and execution as well as team development than corporate management teams (Ruef, Aldrich, & Carter, 2003). In the following, we briefly review three streams of literature on entrepreneurial teams relevant to our project and leading to our research questions.

One important goal of entrepreneurial team research has been to investigate how the composition of the team influences team and venture development. Entrepreneurial teams are often homogeneous in terms of socio-demographic variables (Ruef, et al., 2003), which has been associated with higher team stability (Ucbasaran, et al., 2003). However, research has also shown that ventures benefit from team heterogeneity (Amason, Shrader, & Tompson, 2006; Beckman, et al., 2007). Moreover, research has shown that heterogeneity is connected to team member entry and exit (Ucbasaran, et al., 2003). While some studies found a positive relationship between team member exit and venture performance (Bruton, et al., 2000; Chandler, Honig, & Wiklund, 2005), others found that founder exit reduced venture performance (Bamford, Bruton, & Hinson, 2006), and that there are positive effects of the original founders’ continued presence for firm performance.
Although the consequences of entrepreneurial exit are not clear, “the exit of the founder has a significant effect on the firm and is a key milestone in the organization” (DeTienne, 2010, p. 205). While research on team composition and its changes has advanced our understanding of entrepreneurial teams and their impact on venture outcomes, this literature has largely neglected social interaction processes within entrepreneurial teams (cf. Klotz, Hmieleski, Bradley, & Busenitz, 2014). For example, there has been insufficient investigation how team-level interactions trigger changes in team composition.

Another important research stream has focused on social interactions within entrepreneurial teams. Studies focusing on team interactions that have negative implications for the team and the venture have found, for example, that relationship conflict leads to lower venture performance (Ensley & Hmieleski, 2005) and team member exit (Vanaelst et al., 2006). Work focusing on positive entrepreneurial team interactions showed that team cohesion is positively related to venture performance (Ensley & Hmieleski, 2005) and is an important criterion for experienced investors (Franke, Gruber, Harhoff, & Henkel, 2008). While this stream of literature highlights the impact of the team's social interactions on venture performance (Ensley & Hmieleski, 2005; Klotz, et al., 2014), there is considerable variance in the antecedents of these interactions and how they impact the team's development.

Most research focusing on equity ownership in entrepreneurial firms has addressed distribution of equity with respect to investors or other helpers outside of the firm (Gompers & Lerner, 1998; Kotha & George, 2012). Typically, entrepreneurs need to grant equity in exchange for financial and non-financial resources (Kotha & George, 2012). However, granting equity to others can be painful to entrepreneurs like “giving up part of ‘their baby’” (Lim, Busenitz, & Chidambaram, 2013: 53). Consequently, the distribution of equity has been described as “one of the most complicated and tension-filled” decisions in an entrepreneurial team (Wasserman, 2012: 182). The distribution is influenced, for example, by team members’ prior experiences, social ties, capital investments, and contributions to the business idea (Hellmann & Wasserman, 2011). However, because this distribution cannot be easily changed if founders do not use contingent contracts (Wasserman, 2012), imbalances in the distribution might arise. Because of these far-reaching consequences of equity distribution for entrepreneurial teams, it is crucial to focus on its impact on the social interaction within entrepreneurial teams and, in turn, team and venture outcomes of these interactions. Surprisingly, the sparse research on consequences of equity distribution focuses (to the best of our knowledge) only on financial firm outcomes (Hellmann & Wasserman, 2011; Kroll, et al., 2007).

Based on the research gaps presented in this section, our empirical study is guided by the following overarching research questions:

How does equity distribution in an entrepreneurial team shape social interactions between its members over time and how do the outcomes of these interactions develop for the team and the venture? Why do these effects differ between entrepreneurial teams?
Research Design

As prior research has not yet sufficiently explored our research questions, we suspected that grounding our theorizing in data would enable us to generate additional insights and employed a multiple case study approach. We use a longitudinal design and followed the case teams over an extended time period which allows us to study how a sequence of events produces specific outcomes over time (Van de Ven, 2007).

We focused on ventures from incubators in a German metropolitan area which were founded by an entrepreneurial team. Out of the 289 ventures that we identified, 64 ventures agreed to participate. To select a number of cases we followed a multi-stage theoretical sampling approach (Miles & Huberman, 1994). We first classified each venture by its equity distribution: 35 teams reported an equal equity distribution, 23 teams an unequal distribution, and six teams did not grant us any insight into their equity distribution and were dropped from the sample. Second, we focused on ventures that provided us with rich data including participation in multiple rounds of interviews (see below). From our initial sample, eleven ventures with an equal equity distribution and eight ventures with an unequal distribution provided detailed enough information. Third, when we started to analyze the data from these 19 teams, we realized that it was inappropriate to compare teams with two members and those with more than two members in terms of team interactions (cf. Moreland, 2010) and stability (cf. Ucbasaran, et al., 2003). Therefore, we focused on 16 teams composed of two co-founders to reduce complexity of the interactions observed and facilitate the analysis of attitudinal, affective, and behavioral processes within the team. While this focus represents a limitation to the generalizability of our results, it is consistent with average team sizes in previous research (Ensley & Hmieleski, 2005; Ucbasaran, et al., 2003). Finally, we contrasted the teams which showed the highest levels of positive and negative facets of variables and constructs of interest (cf. Yin, 2009). This focus on ‘extreme cases’ illuminates the core effects associated with equity distribution and thus provides the best starting point to build new theory (Eisenhardt, 1989). By analyzing eight cases, we were able to reach theoretical saturation: when we tried to fit the remaining cases with our emerging theoretical model, we did not find any major disagreements with the model. To protect the participants’ anonymity, we use fictitious names for the members and teams (J1-5 for teams in which equity distribution was perceived to be just and U1-3 for teams in which it was perceived to be unjust).

Data Collection

Our primary data source was semi-structured interviews with the team members. For each of the eight cases we interviewed both team members twice within a time frame of six months with the exception of one team member who exited his team before the second interview (Andrew, U1) and another team member who was not available for the second interview (Ian, U3), resulting in 30 interviews. During the iterative data analysis process it became apparent that follow-up interviews would be beneficial in the five cases of team member exit, resulting in five additional follow-up interviews. We made use of interview guides containing open-ended questions and explored topics such as the team’s background, the business model, and the team interactions (interview 1) and the team/venture development, team decision-making processes, and conflicts...
(interview 2). Follow-up interviews were used for clarification purposes around specific issues that emerged during data analysis. Interviews which typically lasted between 50 and 60 minutes were recorded and transcribed. The collected data amounted to over 400 transcribed pages.

Since interview data typically suffer from biases due to individuals' imperfect recall, we collected additional data. During all interview sessions, field notes were taken on-site observations and we repeatedly reviewed the ventures’ websites. We also collected secondary data from magazine articles and announcements of important entrepreneurship awards. These additional data (318 pages in total) were used to complement and validate the interview data. Finally, we also collected some quantitative data on the teams drawing on established scales for team members' perceptions of relationship conflict (Jehn & Mannix, 2001) and their satisfaction with the team (Jehn, Rispens, & Thatcher, 2010) in online questionnaires in weeks 1, 10, 19, and 28 of our study. Moreover, in week 28 we collected measures on self-assessed team (Shaw et al., 2011) and venture performance (Higashide & Birley, 2002). As the constructs included in our model emerged from the interview data, the quantitative data are only a rough indicator for constructs in the model and were not used to perform detailed statistical analyses.

Data Analysis

We followed an inductive coding strategy (Corbin & Strauss, 2008). An initial coding scheme based on constructs relevant to our research questions was constantly revised throughout the iterative coding process (cf. Miles & Huberman, 1994). Then we composed tables with all interview quotes and archival data per construct and per case. Two coders then assessed the level of the specific category for a particular case (e.g., if relationship conflict for the case team was high, medium, or low). The initial agreement between the coders was satisfying (91.5%; cf. Miles & Huberman, 1994) and unclear cases were discussed between them. Finally, we proceeded with a cross-case comparison to investigate differences between teams with equal and unequal equity distributions (Eisenhardt, 1989; Miles & Huberman, 1994). By oscillating between the table containing the interview quotes and the table containing the construct levels, the most important variables as well as their interrelations emerged.

Equity Distribution, Team Social Interactions, And Entrepreneurial Outcomes

The model including the key constructs and relationships emerging from our data is illustrated in Figure 1. Although the model emerged from the inductive study, we present it here to provide the reader with a roadmap and a preview of key findings. In the following, we describe the relationships and the propositions in detail.

Perceived Justice of Equity Distribution

Focusing on the impact of equity distribution in entrepreneurial teams our data revealed that the team members’ perceptions of justice of equity distribution rather than the actual distribution was a key construct to explain variance in social interactions across teams. Five out of the eight case teams perceived equity to be fairly distributed. Specifically, all members of teams in which equity was distributed equally (J1, J2, J3, J5) perceived distributive justice to be high. A representative example of these teams is Jim’s statement (J2): “Pretty simple: we founded our company together
and each of us got half.” (interview 2). Similarly, team J3 highlighted the importance of “equal treatment” (Larry, interview 1). Remarkably, also both members of one team with an unequal distribution (J4) perceived this distribution to be fair although it was highly unequal (90:10 split). In this case, perceptions of justice were based on the different inputs of both team members into the venture since foundation (see below for a description of the antecedents of justice perceptions).

In contrast, the minority owners in teams U1 (70:30 split), U2 (55:45 split), and U3 (60:40 split) perceived the unequal equity distribution to be unjust and this view increased over time. Minority owner Andrew (U1) described how his negative but accepting view on the equity distribution right after negotiation deteriorated over time. He complained: “At the end of the day the ‘return’ for me has to be evident. By now, I am sincerely questioning that [return].” In contrast, we did not find any evidence that Alice perceived the distribution to be unfair. In team U2, minority owner Ed had a moderately low distributive justice perception at the beginning of our study. In the second interview, he described the equity distribution as the “decision that has annoyed [him] most” and stated that “just half of the shares would be appropriate.” While Emma, U2’s majority owner, perceived the distribution to be fair in the first interview, she complained in the second interview that she should even have had a larger portion of equity. Finally, while minority owner Irene from U3 stated that she was “not so happy” (interview 1) with the distribution and this view deteriorated in the second interview, majority owner Ian described their distribution as fair.

Thus, in our sample perceived justice of equity distribution varied across teams and within teams perceived injustice tended to increase over time. In the following, we will first explore the antecedents of these perceptions and then investigate the impact of perceived justice on teams’ social interactions. Finally, we will connect these team interactions with entrepreneurial outcomes.

Antecedents of Perceived Justice of Equity Distribution

To better understand how the perceived justice of entrepreneurial teams’ equity distribution developed, we explored potential antecedents. Not unexpectedly, the first factor that turned out to influence perceived justice was the actual distribution of equity within the team. Members of teams with an equal distribution were more likely to describe the distribution as just, whereas the minority owners in teams with an unequal distribution were more likely to perceive it as unjust.

Second, consistent with theories on organizational justice, team members who believe that their equity ownership in relation to their contribution to the venture is equal to the other members’ ownership in relation to the others’ contribution perceive the distribution as fair, i.e. distributive justice is high (cf. Colquitt, 2001). In contrast, a perceived mismatch between equity ownership and contribution to the venture resulted in low distributive justice perceptions (Cropanzano, Bowen, & Gilliland, 2007). Typically, members with an equal split emphasized their equal contribution (J1, J2, J3, and J5). Likewise, J4’s members emphasized a match between the founders’ contribution and their unequal equity split as majority owner Doug founded the company and Dan joined later and was less experienced. While the majority members of U1, U2, and U3 all claimed having developed the idea for the venture and deserving an “idea premium” (cf. Wasserman, 2012: 158), the minority owners typically lacked acceptance of the majority owners’ perceived higher contribution resulting in perceptions of injustice.
Finally, previous research found that prior personal relationships between founders explains equity allocation (Kotha & George, 2012; Wasserman, 2012). In our interviews, team members did not explicitly connect their prior personal relationship to the distribution of equity. Importantly, team members highlighted the symbolic nature of equity distribution which was also used to implement certain relationships (e.g., ‘equal partners’ or ‘expert vs. novice’). However, comparing the teams with high and low perceptions of distributive justice revealed some (albeit not consistent) differences in the prior relationships. For example, team J1 consisted of friends, team J2 of former fellow students, and team J4 of former colleagues. In contrast, the founders of team U2 had not had any ties prior to venture foundation. However, teams J3, J5, U1, and U3 all consisted of acquaintances with rather weak ties. In sum, we propose:

**Proposition 1a:** An equal split of equity between entrepreneurial team members increases the likelihood that the equity distribution is perceived to be just.

**Proposition 1b:** A perceived match between entrepreneurial team members’ contribution and equity distribution increases the likelihood that the equity distribution is perceived to be just.

**Proposition 1c:** A closer personal relationship between entrepreneurial team members prior to founding the venture increases the likelihood that the equity distribution is perceived to be just.

**Perceptions of Distributive Justice and Team Interaction Spirals**

The team members’ perceived justice of equity distribution had a strong impact on the interactions emerging within the team. Importantly, one member’s perception of injustice was enough to trigger different interactions in comparison to a team in which all members perceived justice to be high (cf. team minimum score; Barrick, Stewart, Neubert, & Mount, 1998). Depending on the level of justice, two different interaction spirals emerged. These spirals consisted of two variables: **team attraction** and **team repulsion**. Based on our data, we define team attraction as attitudinal, affective, and behavioral factors within entrepreneurial teams shaping the team’s experiences of being an entity with strong common bonds. High intrateam trust and high team cohesion emerged as indicators for team attraction in the interviews. Team repulsion entails the team’s thoughts, feelings, and behaviors connected to a process of drifting apart, important indicators were relationship conflict and social distancing within the team. Team attraction and team repulsion formed mutually reciprocal spirals: High perceived justice of equity distribution triggered positive team interaction spirals in which team attraction increased and, correspondingly, team repulsion decreased over time. In contrast, a team member’s low perception of justice triggered negative team interaction spirals in which team attraction decreased and, correspondingly, team repulsion increased over time. In the following, we will first describe the teams in which positive spirals emerged and then the teams in which the negative spirals emerged.

Teams which perceived distributive justice to be high typically started with rather high levels of intrateam trust and cohesion and these high levels were stable or even increased over the time frame of our study indicating high levels of team attraction. At the same time, we found only weak and decreasing indicators for team repulsion. For example, Paul of team J1 described high levels of trust and cohesion and connected the team attraction to their equal equity split “There are no arguments against it [a 50:50 split]. At the end of the day it is a partner whom you must trust 100%.” Typically, the team members described a mutual increase of team attraction over time.
which resulted in the reduction of conflicts. For example, Jim of J2 described an increase in trust and cohesion and explained his positive view: “At the beginning, we had to discuss more, so we had more controversies. But now we know better how to understand the other’s issues without endless discussions.” Likewise, Doug—majority owner of J4, described some conflicts at the beginning of the collaboration with his co-founder Dan and blamed his own communication style. The reduction in conflicts led to a “very good, very friendly, very partnership-like” team collaboration which is an indicator for an increased team attraction. Despite high level of perceived justice of equity distribution and the initially developing positive team spiral, the pattern in teams J3 and J5 differed from these teams over time and will be described below.

When one team member perceived justice to be low (i.e. teams U1, U2, and U3), intrateam trust and cohesion were clearly lower and were further reduced by substantial conflicts which the teams experienced. Typically, the first conflicts related to the team’s equity distribution and then had a ripple effect and extended to other topics with respect to the team and the venture. For example, when asked about their equity distribution, Emma (U2) admitted that the issue was an unresolved conflict within their team: “We had a short fight [about the equity distribution]. Ok, it was not really short. It actually went on for a relatively long time and we wasted our entire resources [on it].” Also team U3 had several smoldering conflicts and Irene described her low levels of trust in her partner with the feeling that she had “to control everything.” Likewise Andrew from team U1 described escalating conflicts that “severely shattered the level of trust” in the team resulting in a “tense relationship.” These high levels of team repulsion were also characterized by social distancing in the entrepreneurial team including aloofness, withdrawal, and condescension (Siegel & Hambrick, 2005). For example, Ed, U2’s minority owner, accused his co-founder Emma of as being “sort of on an ego trip,” while Emma condescendingly complained that Ed was “irrelevant” for venture success. In the second interview, Irene (U3) showed substantial withdrawal behavior and stated that her collaboration with Ian “had rather no future.”

In sum, our data revealed that perceptions of distributive justice triggered dynamic interaction processes in entrepreneurial teams, which can be described as reciprocal, either positive or negative, interaction spirals where enhancing levels of team attraction diminish team repulsion and vice versa. This was paralleled by the survey data recorded at four points in time across our study. When we compared the team scores of the teams high (J1 to J5) and low (U1 to U3) in perceived justice, we found significant differences in the average satisfaction with the team (as an indicator for team attraction, t(30) = 2.99, p < .01) and relationship conflict (as an indicator for team repulsion, t(29) = 2.02, p = .05). Therefore, we propose:

**Proposition 2a:** High perceived justice of equity distribution triggers a reciprocal, positive team interaction spiral consisting of a mutually reinforcing relationship between increasing team attraction and decreasing team repulsion.

**Proposition 2b:** Low perceived justice of equity distribution triggers a reciprocal, negative team interaction spiral consisting of a mutually reinforcing relationship between decreasing team attraction and increasing team repulsion.
External Threats and Team Interaction Spirals

Interestingly, despite similar starting conditions like other teams with high perceived justice and initially positive interactions, teams J3 and J5 showed a different interaction pattern over time. Both team members of J5 described a decline in trust and cohesion which led to an increase in conflicts and social distancing further diminishing trust and cohesion. For example, in after Sam’s exit, Sean described that over the last six months he had developed “distrust” and finally “challenged everything” Sam did, leading him to condescending behavior, such as accusing his co-founder of lying. Simultaneously, Sam described a variety of conflicts and reported that he started “not [to] trust him [Sean] anymore.” While Lance (J3) described initial improvements in the team with “a more respectful interaction” and their ability “to address problems in a direct and open way,” we learned in a follow-up interview about deteriorating team processes.

A closer look at these teams revealed that they were repeatedly confronted with important external threats exerted by their investors which triggered deteriorative processes within the team. Sean (J5) reported about difficulties in the collaboration with their business angel: “I always find it difficult to bring a third person on board, what you can see if you look at our business angel [...] Each new person that has a leading role changes the entire dynamics [in the team].” In the follow-up interview, Sam presented a negative view on the role of the business angel and blamed him for decreasing trust and cohesion between the team members and for conflicts because of a distinct faultline emerging in the team: “I had a difficult relationship with [the business angel] and for [him and Sean] the relationship was much better.” Likewise, Lance described how J3’s investors wanted to “drive a wedge” between Larry and him. In a follow-up interview, Lance reported several conflicts in the team and his annoyance with Larry’s meticulous working style. However, the negative spiral in team J3 was not a pronounced as in team J5 and Lance emphasized that they agreed on a solution in the team (i.e. Larry’s exit, see below).

These findings parallel previous studies showing that conflicts between entrepreneurs and investors are common (Collewaert, 2012; Sapienza, Korsgaard, Goulet, & Hoogendam, 2000) and theorizing about investor-driven faultlines in entrepreneurial teams (Lim, et al., 2013). Moreover, the findings highlight how investors pose external threats to entrepreneurial team dynamics and thus provoke negative team interaction spirals. Based on the above, we propose:

*Proposition 3: External threats increase the likelihood that teams drift from a positive team interaction spiral emerging from high perceived justice of equity distribution to a negative team interaction spiral.*

Team Interaction Spirals and Entrepreneurial Outcomes

Our data also showed that the two different interaction spirals developing in our teams had different effects on entrepreneurial team stability as well as team and venture performance. First, negative interaction spirals appeared to be difficult to stop and teams experiencing these spirals also experienced team member exit. Andrew exited U1 during our study, Irene (U3) and Sam (J5) left soon after our second interview, and in the year following our study Ed left U2 and Larry left J3. All these exits were preceded by a longer process of erosion in the teams. In follow-up interviews, the members attributed the exit to a substantial extent to problems within the team. For example, when Sam described reasons for his exit from J5, he mentioned a decrease in intrateam trust
and cohesion and that he felt treated in a condescending way by his co-founder which triggered his withdrawal from the team. Similarly, Ed (U2) commented on his severe intentions to quit the venture in the second interview. In the follow-up interview after Ed's exit, co-founder Emma described in detail how the team drifted apart and that they reduced the number of meetings because “it was simply disagreeable to be in a room together.” Only Lance (J3) described Larry's exit as “no big bang,” but the outcome of a joint discussion in the team.

In contrast, all teams with positive interaction spirals continued working together and we did not find any evidence that members intended to exit. In contrast, team members highlighted their close ties and commitment to the team. For example, Paul (J1) stated in the second interview that they were open about the job offers that they frequently got from other firms “because we are certain that we do not want to leave.” Based on the above, we propose:

Proposition 4a: Whereas positive team interaction spirals decrease the likelihood of entrepreneurial team member exit, negative spirals increase the likelihood of exit.

Second, our data revealed that team interaction spirals were connected to entrepreneurial team and venture performance. While we relied on team members’ assessments of team performance, we captured venture performance by three different indicators: Interviews statements, the number of employees and employee growth over our study period, as well as important entrepreneurship awards won by the ventures. Teams with a positive interaction spiral reported high levels of team and venture performance. For example, in teams J1 and J2, members described their complementarity and that their co-founder compensated their weaknesses facilitated by their high levels of intrateam trust. All team members described a positive development of the venture in the second interview. Dan (J4) described venture performance to be “super, super good.” Additionally J1, J2, and J4 experienced employment growth over the course of our study and J2 won two and J4 one important entrepreneurship awards after our study.

In contrast, members of the teams with negative interaction spirals experienced lower team and venture performance. Team U1 failed in a project for a key client due to a lack of communication in the team and constantly struggled to generate revenues. Although team U2 won a business plan competition before our study, this success did not continue over time. The team could not make the technology work and did not attract customers. In a follow-up interview, we learnt that Emma had to close down the venture and she summarized that “this was a bad team.” Irene (U3) provided several examples of low team performance which were caused by a lack of communication mainly due to Ian’s withdrawal from the team. Shortly before her exit, she admitted that she “did not see any prospects” for the team and the venture.

For J3 and J5 the development of team and venture performance was more complex. Both teams first reported high levels of team and venture performance. While drifting from a positive to a negative spiral, the founders of J5 reported a decrease of team and venture performance. Sam complained about a lack of communication which resulted in poor teamwork. In a follow-up interview after Sam's exit, Sean called the venture “a failure.” This is paralleled by no enduring employment growth and—to the best of our knowledge—no awards for J5. While Lance (J3) also admits weaknesses of their team work, he still assessed team and venture performance to be high. J3 won several awards, closed a new financing round, and experienced employment growth indicating that the negative development for J3 was not as pronounced as for J5.
Survey data indicated positive correlations between team-level scores of team satisfaction and team \( (r = .92, p < .01, n = 8) \) as well as venture performance \( (r = .70, p = .05, n = 8) \) and negative correlations (significant only at the 10% level given the small sample size) between team-level scores of perceived relationship conflict and team \( (r = -.92, p < .01, n = 8) \) as well as venture performance \( (r = -.66, p = .08, n = 8) \) at the end of our study. Thus, team interaction spirals were connected to important entrepreneurial outcomes. We propose:

**Proposition 4b:** Whereas positive team interaction spirals enhance perceived entrepreneurial team performance, negative team interaction spirals diminish perceived entrepreneurial team performance.

**Proposition 4c:** Whereas positive team interaction spirals enhance venture performance, negative team interaction spirals diminish venture performance.

**Discussion And Conclusion**

We motivated this study by the limited current theorizing and empirical work on the consequences of entrepreneurial equity distribution. Our data revealed that not the equity distribution per se, but the team members’ perceived justice of this distribution was a crucial factor and substantially impacted the development of team interactions. We now discuss the study’s theoretical contributions to research on entrepreneurial imprinting, justice, and exit.

**Theoretical Implications**

Research on imprinting assumes that decisions made by entrepreneurs early in the venture’s life leave a lasting imprint on its development. Several studies following this assumption have focused on the entrepreneurial team and found that the founding team’s structure and experience (Beckman & Burton, 2008), heterogeneity in team members’ functional backgrounds (Beckman, et al., 2007), and the team members’ shared prior work experiences (Leung, Foo, & Chaturvedi, 2013) explain later team and venture development. We focus on the “first deal” (Hellmann & Wasserman, 2011, p. 1) in an entrepreneurial team, the distribution of equity and results of our inductive study extend current research on imprinting by considering social interactions within the entrepreneurial team. With this focus on ‘social imprinting’ instead of the static team composition, we identified perceptions of distributive justice, rather than the actual distribution of equity, to impact interactions within the entrepreneurial team and, in turn, team and venture development. Additionally, our model highlights the important role of contextual factors in shaping imprinting effects and explaining variance across ventures. Even though teams in our sample had similar starting conditions, their development did not follow the same path, but was additionally shaped by the team’s specific contextual situation. More specifically, external threats imposed upon the teams J3 and J5 by their investors caused a drift from a positive to a negative interaction spiral.

Second, we contribute to the literature on justice in entrepreneurial and organizational contexts. Entrepreneurial teams represent an interesting context to analyze perceptions of justice because in contrast to employees in established organizations these teams make their decisions about reward distributions without a supervisor (Blatt, 2009). In established organizations, employees’ participation increases perceived justice of unfavorable distributions (Folger, Rosenfield, Grove, & Corkran, 1979). Although our entrepreneurial team members were involved in the decision of
equity distribution, we observed substantial variance in perceived distributive justice across teams and within teams over time. First, these findings emphasize the importance of equity ownership consistent with previous work highlighting the connected financial rewards (Hall & Woodward, 2010) and level of power and control (Nelson, 2003). Second, entrepreneurial team members are probably more affected by an unjust distribution because in contrast to employees who can reduce their input in their work to restore justice (Cropanzano, et al., 2007), it is counterproductive for entrepreneurial team members to invest less effort as this might harm the venture they own, resulting in a smaller piece of an even smaller cake.

Moreover, high perceived distributive justice represented a beneficial foundation for team interactions. These findings complement Blatt’s proposition (2009) that communal schemas and the use of contracting between entrepreneurial team members can help to overcome the challenges of novelty and to develop trust. However, we provide an important extension by focusing on the perceptions of contents (i.e. are these contents perceived as fair?) rather than the extent to which contracting is used. If contracts are not perceived as fair, it appears that the development of intrateam trust is impaired. However, although, on average, high perceived justice prevented a negative team development, this was not always the case. Thus, our results demonstrate the benefits of distributive justice in entrepreneurial teams, but also the limits of its effects.

Third, our data linked team interaction spirals with important entrepreneurial outcomes. While the performance effects of interaction spirals parallel previous findings on the association between entrepreneurial team interactions and team (Jehn & Mannix, 2001; Mach, Dolan, & Tzafrir, 2010) as well as venture performance (Ensley & Hmieleski, 2005), our results show how these interactions and the associated dynamic and interdependent social processes over an extended period of time impact team and venture performance. The importance of a dynamic perspective is particularly evident for team J5 which started to develop a positive spiral but due to its specific context could not capitalize on this ‘good start’ in terms of achieving high performance in the end. These findings emphasize the benefits of both a dynamic approach and the consideration of context when studying the link between team interactions with entrepreneurial outcomes.

Finally, we complement previous research on entrepreneurial exit by providing insights how social interaction processes trigger exit. The amplifying negative team process was particularly destructive because an increase in team repulsion reduced the team interactions, and remaining interactions were less rewarding due to a decrease in team attraction. Thus, entrepreneurs’ exit decisions are not only based on an economic threshold level (Gimeno, et al., 1997), but also on a ‘social threshold’ level capturing the minimal acceptable level of negative experiences within the team. Consistent with research indicating that some investors trigger entrepreneurial turnover (Bruton, et al., 2000), we found that the investor’s pressure shifted teams from a positive to a negative spiral despite high perceived justice of equity distribution.

**Limitations, Future Research, and Conclusions**

As for all case-based research, the generalizability of our model is limited by the small sample size. Future studies should pursue large-scale approaches to test important relationships in our model. Using a longitudinal design, researchers could follow teams over time to further support the effects proposed by our model. Moreover, we focused only on dyadic teams to increase
comparability and disentangle the complexities of interpersonal relationships in larger teams. Future studies should test whether our findings presented are also valid in larger teams in which additional effects, such as coalition building (Moreland, 2010) could be observed.

As equity ownership is also connected to entrepreneurs’ control and power in their firms (Nelson, 2003; Wasserman, 2012), another interesting avenue for future research building on our findings would be to study control and power in entrepreneurial team decision making. In teams with an unequal split, majority owners can outvote the other team members whereas an equal split entails equal power in team decisions. The teams in our sample, however, typically described their decision-making processes as balanced and involving both partners. Interestingly, some teams with an equal distribution experienced challenges in their decision making when it was difficult to find a compromise indicating that an equal distribution can slow down decision making. Future research could explore the team decision making processes connected to the members’ ownership control and compare decision speed, satisfaction with the decision, and the members’ commitment to the decision across teams with different levels of perceived justice of equity distribution.

Finally, future research could further explore the impact of investors as external threat on team interactions over time. Our data provided first evidence for this effect: however, only J3 and J5 had external investors. While we found some similarities between J3 and J5 with respect to the negative team interaction spirals that investors triggered in these teams, there were also differences in the erosiveness of the investors. One reason for this difference could be the differences in venture performance between J3 and J5 as Sapienza et al. (2000) suggest that lower levels of venture performance increase conflicts between investors and entrepreneurs. This finding potentially entails an even more complex relationship between team interaction spirals and venture performance such that venture performance could moderate how external threats affect entrepreneurial teams.

To conclude, the distribution of venture equity within the entrepreneurial team is one of the first decisions team members need to make. This inductive study offers new insights by showing that high perceived distributive justice triggers reciprocal, positive team interaction spirals, while low perceived justice triggers negative team interactions spirals. Moreover, negative team spirals further reduce perceived justice of equity distribution. These results suggest a dynamic perspective on entrepreneurial imprinting and the consequences of equity distribution in entrepreneurial teams. We hope that our study stimulates further research on the social consequences of early imprinting effects in the venture’s life for entrepreneurs, their teams, and the venture’s employees.

CONTACT: Nicola Breugst, nicola.breugst@tum.de; Technische Universität München, Germany.

REFERENCES


**FIGURES**

Figure 1: A model of perceived justice of equity distribution and its impact on entrepreneurial team interactions and outcomes