Angels, Entrepreneurs and the Dark Side of Trust

Key Concept
Trust is often seen as the key to successful partnerships with angel investors, many of whom provide ‘hand-holding’ services as well as capital for entrepreneurs. But recently published research suggests it can threaten the long-term prospects of a business. Entrepreneurs are, it seems, sometimes so keen to preserve high levels of trust in their relationships with ‘angels’ that they avoid experimentation — and fail to take the kinds of decisions that secure re-investment.

Idea Summary
The importance of trust to individuals and organizational teams is widely acknowledged by scholars. Recent studies, however, have started to explore its darker side in relationships — especially in innovative and dynamic settings. Research by Maastricht University and Vlerick Business School contributes to this stream of inquiry by examining how perceptions of trust in entrepreneur-angel investor partnerships affect angels’ assessments of venture performance.

One of only a few studies to recognise that perceptions of trust may differ significantly between parties, it is based on data collected from surveys of both the lead entrepreneur and angel investor in 28 Belgian and 26 Californian ventures. (Most businesses in the sample were in the ‘dynamic’ sectors of software and high-tech manufacturing.)

The study focuses on cognitive-based trust — that is, trust based on an understanding of moral character and qualities such as fairness, integrity, consistency and reliability — and tests the effects of entrepreneurs’ and angel investors’ perceptions on post-investment performance assessment separately.

The researchers show that while trust has considerable benefits, it can also lead to risks of ‘decision-making rigidities’. Trust in the study is positively associated with the quality of information exchanged between entrepreneurs and angel investors. Once, however, the quality of communication has been accounted for, the effects of both partners’ intra-team trust perceptions are found to diverge — radically. Where angels perceive a high level of trust in the relationship, evaluations of the performance of a venture are more positive (possibly because setbacks are attributed to external contingencies); where entrepreneurs perceive a high level of trust, on the other hand, they’re more negative.

The researchers also found that the negative effect of the entrepreneurs’ intra-team trust perceptions actually outweighed its positive influence via
communication quality. While this finding could be due to the high levels of trust reported by the sample, it suggests that the perception of being in a strong trusting relationship might, over time, lead to an over-emphasis on preserving trust and the status quo and to behaviours that stifle innovation and damage performance.

The study points to the need for greater awareness of, and further inquiry into, the risks involved in developing and maintaining strong bonds between partners — and to the limits of trust as an organizing principle.

Given post-investment assessments are likely to determine whether the angel will reinvest or abandon the venture, getting trust 'right' could mean the difference between success and failure.

**Business Application**

There are practical implications — for both entrepreneurs and their investors.

The study underlines the importance of effective communication in the investment relationship, suggesting that the effort taken by entrepreneurs to provide timely, accurate, adequate, complete and credible information 'pays off' in more positive assessments from angels.

At the same time, however, it calls for a 'balanced' approach to trust building and for increased awareness of the risks. While developing trust is crucial in the pre-investment stages to ensure funding, the desire to preserve trust post-investment should not come before the long-term interests of the business. (Entrepreneurship, almost by its nature, demands flexibility, adaptability and responsiveness to change.)

Building in mechanisms early on that mitigate the risks of ‘trust-related dysfunction’ may be essential. There may, for example, be a case for the angel investor taking on the role of resident ‘devil’s advocate’. By agreeing upfront that it is their job to probe the entrepreneur when strategic decisions need to be taken, the angel may be able to create an environment where debate is welcomed, creative thinking encouraged and rigid decision-making processes avoided.

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**Further Reading**


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**Further Relevant Resources**

Yannick Bammens’s profile at Maastricht University
Veroniek Collewaert’s profile at Vlerick Business School
Vlerick Business School’s profile at IEDP