The Importance of Trust for Investment: Evidence from Venture Capital

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Abstract

A recent literature finds a positive relationship between trust and economic growth & trade in macro-level data, whose nature makes it difficult to separate out the direction of causality. In this paper we use a micro-level dataset on individual venture capital investments, where trust (measured bilaterally as the people's trust in one country, for people from different countries) is clearly exogenous. We find that trust has a significant effect on the likelihood that a venture capitalist invests in a company. This holds even after accounting for many alternative factors likely to influence investment, such as information or geographic distance between investors and companies. Our hand-collected dataset also provides information on contractual structures. If investors have less trust, they rely more on other investors, they choose financial securities that provide more downside protection, and they are less likely to implement contingent control structures. The analysis suggests that trust is an important economic factor that affects the formation of investments, as well as their contractual structure.

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"There are countries in Europe [...] where the most serious impediment to conducting business concerns on a large scale, is the rarity of persons who are supposed fit to be trusted with the receipt and expenditure of large sums of money." (John Stuart Mill)

1 Introduction

The neoclassical tradition does not have a role for trust. Still, many economist, including John Stuart Mill, intuitively recognize the importance of trust for economic transactions. A recent literature examines the importance of "social capital" for economic growth. Trust is a central component of social capital. The work of Knack and Keefer (1997), Temple and Johnson (1998), and Zak and Knack (2001) establishes a positive relationship between trust and economic growth. Yet, this macro-oriented literature typically struggles with issues of endogeneity. A more micro-based approach holds promise for identifying more precisely the effect of trust on economic transactions.

In this paper we use a micro-level dataset on venture capital investments. The data contains information on how venture capitalists across Europe invest in companies that may be located in the same or different countries. We use a measure of bilateral trust among nations to examine two central issues: Does trust affect the likelihood of making an investment? And does the contractual structure between the investor and entrepreneur compensate for any lack of trust?

What do we mean by trust? In a recent survey article about social capital, Durlauf and Fafchamps (2006) distinguish between generalized and personalized trust. The former pertains to the preconceptions that people of one identifiable group have for people from another identifiable group. The latter concerns the evolving relationship between two specific agents. In this paper we focus solely on generalized trust, and think of it as the subjective belief that an agent places on the probability of honest dealing. Given its subjective nature, an appropriate measurement of trust requires surveying of opinions. We adopt the approach of Guiso, Sapienza and Zingales (2004), to use the Eurobarometer data on bilateral trust among nations. This measure is based on the responses of citizens in one country, about the trustworthiness of citizens from all other European countries, including their own.

Why study trust in the context of venture capital? There are two main reasons why the venture capital investments provide an almost ideal testing ground for the economic importance of trust. First, the financing of a new company inherently involves limited information and high uncertainty, in the Knightian sense. Moreover, there is a lot scope for opportunistic behavior. Under these circumstances it is reasonable to conjecture that subjective beliefs about trustworthiness matter. Second, the venture capital industry is tiny relative to the economy. According to the European Venture Capital Association, total investments in venture capital (excluding buyouts) accounted for less than 0.1% of European GDP in 2004. Venture capital activity is clearly irrelevant to the formation of trust among nations. This means that we have a setting where we need not worry about endogeneity problems: trust among nations can affect individual venture capital investments, but these investments do not have a reverse effect on trust among nations.

Our data consists of European venture capital investments for the period 1998-2001. This hand-collected dataset has several important strengths. It contains investors and companies from all across Europe, generating rich variation in investment patterns. It contains some information not commonly found elsewhere, such as the precise geographic location of every single company and investor, which allows us to calculate the exact distance between every investor–company pair. Most important, it contains some detailed information about contracts, including the structure of cash flow and control rights. Such contractual detail cannot be obtained from any publicly or commercially available database.

One obvious challenge is to distinguish trust from other factors that might explain investment behavior. Our data are rich enough to allow the use of econometric models that control for investor and even company fixed effects. This alone eliminates a large number of alternative interpretations. For example, fixed effects take care of any systematic differences in the quality of investors or companies. Indeed, with the fixed effects in place, the only variables that matter are those that concern the relative position of the investor vis-à-vis the company. Our trust variable measures one aspect of such a relative position. It varies at what we call the country dyadic level, i.e., it varies for each pair of investor's country and company's country. One important alternative explanation is that investment behavior is driven by the availability of information. For this, we construct a country dyadic measure of the amount of information about other countries available in the business press. Other alternative explanations concern transaction and enforcement costs. For this, we consider the existence of a common language and whether two countries share the same legal origin. We also control for differences in GDP, geographic distance, and for how a company fits with an investor's industry and stage preferences.

We develop our empirical analysis in two parts. In the first part we ask whether trust affects investment decisions. We consider the sample of all potential deals and find that higher trust significantly increases the probability of making an investment. The effect continues to hold across a number of specifications. The analysis also show what other factors influence investments, most notably geographic distance (see also Petersen and Rajan, 2002). In the second part we ask whether contracts compensate for any lack of trust. We use the sample of realized deals to examine three issues. First we ask whether the investor brings other investors into the deal. We find that with more trust, an investor is more likely to invest on his own, and more likely to lead a syndicate rather than being a follower. The investor's share in the total investment amount provided also increases with trust. This suggests that an investor's willingness to take responsibility for the deal increases with trust. Second, we inquire about the financial securities used in the transaction. Building on the venture capital literature (discussed below), we focus on the extent to which an investor requires securities that provide 'downside protection'. This means that the financial contract protects the investor in case of poor company performance, and can be achieved, for example, with debt or convertible preferred equity. We find greater use of downside protection with lower trust, suggesting that the security structure is used to alleviate investors' lack of trust. Third, we examine the allocation of control rights. We find that the use of contingent control rights increases with trust. This result seems surprising at first, since contingent control rights are not used to assuage

any lack of trust. Instead, it appears that high trust is required before two parties agree on contracts that involve the use of sophisticated control arrangements, such as making control contingent on performance.

Our paper builds on the seminal work of Guiso, Sapienza and Zingales (2004), which establishes the importance of trust for trade and investment flows. One of the major concerns in their work is the potential endogeneity of trust. They use a number of new and highly original instruments (including genetic similarity), and find that trust remains significant even after instrumentation. Our paper extends and complements their work in several ways. Focusing solely on micro-level data, we eliminate any concern about the endogeneity of trust. Studying the effect of trust within the well-defined context of the venture capital industry allows us to control more finely for alternative explanations. Moreover, our analysis goes on step further, asking how trust affects contractual structures.

Our results naturally contribute to the broader literature on social capital. See Dasgupta (2003) and Durlauf and Fafchamps (2006) for some excellent surveys. Much of this literature has focused on the importance of trust in an environment in which there is no legal enforcement. For example, Neace (1999) documents that entrepreneurs in the former Soviet republics consider trust a key criterion for business success. Johnson, McMillan and Woodruff (2002) show that well-functioning courts are a prerequisite for entrepreneurs to trust and contract with external suppliers. Our study shows that trust may continue to play a role, even in the context of developed countries with decent levels of legal enforcement. There is also a literature on how trust between workers and employers reduces transaction costs and increases productivity (Kramer and Tyler, 1996; Levi, 2000; Thoms, Dose and Scott, 2002). Note, however, that this paper does not try to explain the formation of trust itself. See Alesina and La Ferrara (2002), Glaeser et. al. (2000), as well as Guiso, Sapienza and Zingales (2004) for some seminal papers on this important question.

The issue of trust has also arisen in the emerging behavioral finance literature. The most closely related paper here is Guiso, Sapienza and Zingales (2005), who document that trust helps to explain the willingness to invest money in the stock market. Guiso, Sapienza and Zingales (2004) also explore how trust affects portfolio investments across countries. In a broader sense, the issue of trust is also related to the well-known home bias puzzle (French and Poterba (1991), Karolyi and Stulz (2003), Lewis (1999)).

Our paper focuses on generalized trust, as opposed to personalized trust. A large sociology literature examines the importance of personalized trust within social networks (see, for example, Burt, 2005). Hochberg, Ljungqvist and Lu (2006) apply network measure to the venture capital industry and show that network centrality is associated with better performance.

Our paper makes a novel contribution to the venture capital literature, introducing trust as an important factor that has not been considered so far. The analysis builds on a number of papers that explain the contractual features observed in venture capital. Brander, Amit and Antweiler (2002), Casamatta and Haritchabalet (2003) and Lerner (1995) explain syndicate formation. Several theory papers explore optimal security structures in venture capital. See Berglöf (1994), Casamatta (2003), Cestone (2001), Cornelli and Yosha (2003), Hellmann (2006), Repullo and Suarez (2004), Schmidt (2003), and the references contained therein. For models of optimal control, see, among others, Dessein

(2005) and Hellmann (1998). Gompers (1997), Hellmann and Puri (2002), and Kaplan and Strömberg (2003, 2004) provide rich empirical evidence. A recent spade of papers extends this empirical work and examines how legal systems influence venture capital contracts. See, in particular, Bottazzi, Da Rin and Hellmann (2005), Cumming, Schmidt and Walz (2005), Kaplan, Martel and Strömberg (2003), and Lerner and Schoar (2005). The analysis of these papers turns out to be largely orthogonal to this paper, since our country fixed effects already absorb all cross-country differences in legal systems. The effects of trust observed here cannot be merely explained by differences in legal systems.

The remainder of this paper is structured as follows. Section 2 explains our data and variables. Section 3 examines the effect of investment formation. Section 4 examines the effect of trust on contracts. It is followed by a brief conclusion.

2 Data and variables

Table 1 provides descriptive statistics for all the variables used in the analysis.

2.1 Data on venture investments

We build this paper on data which come from a variety of sources. Our primary source is a survey of 750 venture capital firms in the following seventeen European countries: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, and the UK. Venture firms were included in our sample if they satisfied three conditions: (i) they were full members of the European Venture Capital Association (EVCA) or of a national venture capital organization in 2001, (ii) they were actively engaged in venture capital and (iii) they were still in operations in 2002.[1]

We asked each venture capital firm about the investments they made between January 1998 and December 2001. More precisely, for each portfolio company we asked information only on the first round of venture financing. The questions centered on key characteristics of the venture firm and on their involvement with portfolio companies. We also asked information on some characteristics of the firm's venture partners and on its portfolio companies.[2]

We received 124 usable responses. Some of these were incomplete, in which case we contacted the venture firm and retrieved the missing information whenever possible. We then augmented the survey data with information from several sources, ranging from websites, commercially available databases (Amadeus, Worldscope, and VenturExpert), and trade publications. We use information from these sources both to obtain missing

[1] We excluded from our survey private equity firms that *only* engage in non-venture private equity deals such as mezzanine finance, management buy-outs (MBOs) or leveraged buy-outs (LBOs), but we included private equity firms that invest in *both* venture capital and non-venture private equity deals. For these, we considered only their venture capital investments. See Fenn, Liang and Prowse (2003) for a discussion of the structure of the private equity market.

[2] Throughout the paper we reserve the term 'firm' for the investor (i.e., the venture capital firm) and the term 'company' to the company that receives the venture capital financing.

information and to cross-check the information obtained through the survey. Such cross-validation further enhances the reliability of our data.

While there is some variation in response rates across countries, our data represent a comprehensive cross-section which provides a good coverage of all countries, with an overall response rate well over 16%. This response rate is larger than the typical response rate for comparable surveys of industrial firms, which is around 9% (see the discussion by Graham and Harvey (2001)). No single country dominates the sample, and no country is left out. Remarkably, the larger venture capital markets (France, Germany, and the UK) show a response rate above 13%. Finally, our data are not dominated by a few large respondents: the largest venture capital firm accounts for only 5% of the observations, and the largest 5 venture capital firms for only 16% of the observations.[3] For a more extensive discussion of the data, see Bottazzi, Da Rin and Hellmann (2004, 2005).[4]

2.2 Unit of observation

Before we explain the construction of our main variables, it is useful to clarify the various units of observation used in this paper.

In the first part of the analysis, we focus on the formation of deals. For this we construct the sample of all potential deals, consisting of every possible pairing between investors which have responded to our survey and their portfolio companies. The unit of observation is the individual investor-company pair (Sorensen, 2005). We construct such pairs from the 109 venture firms and the 1,198 companies in our dataset. For each company we consider that it could in principle be financed by any of the respondent venture firms. We also take into account that some individual pairs are not potential deals because the venture capitalist began operations after the date that the company was seeking an investment. Our potential deals dataset includes 107,309 potential deals.

One obvious limitation of our analysis is that to be included in our sample, a company must have received funding from at least one investor. Naturally, we cannot observe all the "marginal" companies that never received any funding from any venture capitalist.[5] At a conceptual level we may ask what it means to exclude these marginal potential deals. Our analysis examines whether trust affects investment decisions among all "infra-marginal" companies. This excludes any effect that trust may have on the marginal companies. It is therefore likely that our analysis understates the total economic effect of trust.

In the second part of the analysis we focus on the question of how trust affects venture capital deals. For this part of the analysis we use what we call the realized deals sample, which consists of all the actual investments that we observe in our data. Our realized deals sample contains a total of 1,259 deals, into 1,198 companies, made by 109 venture

[3] In Bottazzi, Da Rin and Hellmann (2004, 2005) we report some additional checks that we performed to confirm the representativeness of this dataset.

[4] We were not able to use information for 15 venture firms (and their portfolio companies) for the following reasons. Eight venture firms are from either Norway or Switzerland, countries for which there are no available data on trust. The remaining venture firms invested solely outside the European Union or did not provided us with sufficient information (such as reporting the date of each of their investments, see the discussion in the next section).

[5] Note that even if we did, their observations would fall out of the regression by the time we consider the conditional logit model.

capital firms. The reason there are more deals than companies is that some companies receive financing from more than one of our venture investors.

2.3 Dependent variables

In the first part of the analysis we ask whether a particular investor invests in a particular company. The dependent variable is DEAL, which is a dummy variable that takes the value 1 if the venture capital firm has invested in a particular company; 0 otherwise.

In the second part of the analysis we consider a number of dependent variables that address three conceptual issues: the extent an investor relies on other investors, the types of securities used, and the structure of control rights. For this we construct several dependent variables.

To measure the extent of other investor's involvement, ideally one would like to gather data on all the syndication partners. However, we could not ask our survey respondents to provide this much detail for each of their investments. We therefore limited ourselves to two questions about syndication: *Was this round syndicated?* (Possible answers were: *Yes, No.*) and *If Yes, was your firm the lead investor?* (Possible answers were: *Yes, No.*). Based on the responses to these questions, we construct two variables that capture the level of other investor's involvement. SOLO is a dummy variable that takes the value 1 if the investor was the sole investor (i.e., the deal was not syndicated); 0 otherwise. LEADER is a dummy variable that takes the value 1 either if the investor was the lead investor, or if the investor was the sole investor; 0 otherwise. Our survey also included two questions about the amounts of money invested. Specifically it asked about the *amount invested by your firm at this round* and about the *total amount raised by the company at this round*. Based on these responses we construct the following variable. INVESTMENT-SHARE is the percentage of the total amount raised by the company that is provided by the responding investor.

SOLO, LEADER and INVESTMENT-SHARE provide three alternative ways of measuring the same fundamental concept, namely the extent to which an investor relies on other investors to make the investment. Brander, Antweiler and Amit (2002) argue that venture capitalists rely more on other investors when they are sufficiently uncertain about the quality of an investment. In our context, the natural hypothesis is that trust decreases the extent to which a venture firm relies on other investors to make the investment. Higher values of the dependent variables indicate less reliance on other investors, so that we hypothesize a positive relationship between trust and these dependent variables.

Turning to the financial structure, our survey inquired about the types of securities used for each deal, specifically asking: *Which of the following financial instruments has your firm used to finance this company?* Possible answers were: *common equity; straight debt; convertible debt; preferred equity; warrants.*[6] We consider straight debt, convertible debt and preferred equity as 'downside securities,' since they all give the venture capitalist additional cash flow rights on the downside. DOWNSIDE is a dummy variable that takes the value 1 if the deal includes at least one downside security, and 0 otherwise.

[6] In the instructions to the survey we specified functional definitions of these different financial instruments in order to ensure consistency of responses.

For control rights, our survey instrument asked: *Does your firm has a right to obtain control of the board of directors contingent on the realization of certain events?* (Possible answers were: *Yes, No.*). Based on this, BOARD CONTROL is a dummy variable that takes the value 1 if the venture capital firm responded *Yes*, and 0 if it responded *No*.

In the introduction we already mentioned that there is a literature that explains the use of financial securities and control rights in venture capital. The issue of trust, however, is not directly addressed in this literature. A natural hypothesis is that trust decreases an investor 's need for contractual protection. In terms of securities, this implies that greater trust is associated with less downside protection. In terms of control rights, this would mean that greater trust is associated with less contingent control. However, an alternative hypothesis for control rights is that trust may be a prerequisite for the use of sophisticated control structures that rely on the verification of certain contingencies.

2.4 Independent variables

2.4.1 Country-dyad level

Some of our dependent variables vary at a level that we call a "country dyad," which is the unique pair of an investor's country with a company's country. Table 2 shows the correlation structure of the independent variables that vary at the country-dyad level.

Central to the analysis is our measure of trust. Our analysis is based on the Eurobarometer measures of trust, previously used by Guiso, Sapienza and Zingales (2005), which describe the Eurobarometer survey in detail. Eurobarometer is a large general purpose survey about the social and political attitudes of citizens of the European Union. The survey is executed periodically for the European Commission since 1970. The trust measures are derived from the 1995 edition of the Eurobarometer survey. Note that we deliberately chose not to collect trust data directly from our survey respondents, since such a measure would have serious endogeneity problems. The Eurobarometer measures, on the contrary, have the important advantage that they are clearly exogenous to the investments made by venture capitalists.

Our trust variables are calculated by taking the responses to the following question: *"I would like to ask you a question about how much trust you have in people from various countries. For each, please tell me whether you have a lot of trust, some trust, not very much trust or no trust at all."* The answers are coded over a scale from 1 (no trust at all) to 4 (a lot of trust). TRUST-PERCENTAGE is computed as the percentage of the individuals which respond 4—i.e., that trust a lot people from the other country. TRUST-LEVEL is computed as the average response.

How reliable are these measures of trust? First, note that the bilateral nature of the data distinguishes between being trusting and being trustworthy (see also Glaeser et. al. (2000)). Second, we notice that the trust measures reflect many of the patterns one would intuitively expect: People typically have the highest trust for their own country; Scandinavian countries receive a lot of trust and are also more trusting; the British trust the French less than other nations; and the French are happy to reciprocate that pattern. Moving beyond, we examine how the Eurobarometer measures relate to the World Values Survey (WVS) measure of trust, which has played a central role in the prior literature

(Knack and Keefer (1997)). A strong correlation between the WVS and Eurobarometer measures would suggest a reliable measurement of trust that does not depend on the details of how the surveys were implemented. The WVS survey question is *"Generally speaking, would you say that most people can be trusted, or that you can't be too careful in dealing with people?"* The main difference with the Eurobarometer is that the WVS only measures the overall level of trust held by citizen of one country, rather than bilateral country-dyadic trust. We calculate that the WVS trust measure has a correlation coefficients of 0.48 with TRUST-PERCENTAGE and 0.42 with TRUST-LEVEL, both of which are significant at the 1% level.[7] This provides some reassurance about the reliability of our trust measures.

The remaining country-dyadic variables are the following:

DOMESTIC is a dummy variable that takes the value 1 if the investor and company are from the same country, 0 otherwise.

INFORMATION is calculated as the percentage of times a country is mentioned in the financial sections of another country's newspapers. The data is obtained from the Factiva database, which contains information about the extent of financial press coverage available in each country. For each country dyad we record the number of articles in the financial section of country i's main newspaper, that mentioned country j, or citizens of country j, in the headlines (including the case i=j). We divide this number by the total number of articles in the financial section.

GDP-DIFFERENCE is the absolute difference in the levels of GDP (1998–2001).

COMMON-LANGUAGE is the product of the percentage of people who speak the same language in each pair of countries, summed across all primary languages spoken in those two countries. The data comes from www.ethnologue.com.

SAME-LEGAL-ORIGIN is a dummy variable that takes the value 1 if the investor and company are located in country with the same legal origin; 0 otherwise. Following La Porta et. al. (1997) we distinguish between four legal origins: common law, French-origin civil law, German-origin civil law and Scandinavian-origin civil law.

2.4.2 Other independent variables

We now turn our attention to all other independent variables, which vary at a level different from that of the country dyad.

DISTANCE is the natural logarithm of one plus the distance between the venture capital firm and the company. We identify the exact longitudinal and latitudinal coordinates for each venture capital firm and company. This data is obtained from www.multimap.com. We then use the standard geodetic formula to compute the distance in kilometers. This variable differs for each potential deal.

INDUSTRY is set of a dummy variables that characterize companies' sector of operations. We obtain the data from our survey instrument, which gave the following choices: *Biotech and pharmaceuticals; Medical products; Software and internet; Financial services;*

[7] This correlation uses the Eurobarometer trust measures expressed for all countries in our sample. Alternatively, we may also limit the comparison to the Eurobarometer trust measures expressed only for citizens of the same country. In this case, we found correlation coefficients of 0.41 with TRUST-PERCENTAGE and 0.38 with TRUST-LEVEL.

Industrial services; Electronics; Consumer services; Telecommunications; Food and consumer goods; Industrial products (including energy); Media & Entertainment; Other (specify). These variables vary at the level of the individual company.

STAGE is a dummy variable that takes values 1 if a company's stage is reported as seed or start-up; 0 otherwise. We obtain the data from our survey instrument, which asked: *Indicate the type of your first round of financing to this company (check one).* Possible answers were: *Seed; Start-up; Expansion; and Bridge.* This variable varies at the level of the individual company.

INDUSTRY–FIT is the share of investments of a venture capital firm in the same industry in which the company operates. This variable is constructed within the dataset and is based on the above definition of INDUSTRY. This variables differs for each potential deal.

STAGE–FIT is the share of investments of a venture capital firm in the same stage at which the company is receiving financing. This variable is constructed within the dataset and is based on the above definition of STAGE. This variables differs for each potential deal.

We also construct a set of dummy variables for the investor's countries, and a separate set of dummy variables for the company's countries.

3 The role of trust for deal formation

3.1 Methodology

We begin by asking what factors affect a venture capitalist's decision to invest in a company. This requires estimating the probability that a specific venture capitalist invests in a specific firm. Formally, our econometric specification is given by

$$DEAL_p = \alpha + X_n'\beta_n + X_p'\beta_p + X_i'\beta_i + X_c'\beta_c + \varepsilon_p$$

Let i index investors and c index companies, and let $p = (i, c)$ index the investor-company pairs. The dependent variables is DEAL, which is a dummy variable for whether, in a given pair p, the investor i makes a deal with company c. The intercept term is denoted by α. The vector X_n' represents variables that vary at the country dyadic level, namely TRUST, DOMESTIC, INFORMATION, GDP-DIFFERENCE, COMMON-LANGUAGE, and SAME-LEGAL-ORIGIN. The vector X_p' represents variables that vary at the investor-company pairs level, namely DISTANCE, INDUSTRY-FIT and STAGE-FIT. The vectors X_i' and X_c' represent variables that vary across investors and companies respectively. We discuss them below. Since many of the independent variables vary at the level of the country dyad (n), we cluster the standard errors of ε_p at the level of the country dyad. Clustering also implies the use of robust standard errors.

To estimate the probability that a deal occurs, our base model uses a logit model (we obtain the same result also using a Probit). To control for investor characteristics we can afford to use a complete set of investor fixed effects (i.e., 109 dummies). This is clearly the most powerful way of controlling for any effects that are investor-specific, including, of course, the investor's nationality. To control for company characteristics, we use STAGE,

INDUSTRY and a complete set of country fixed effects. It is worth explaining the strength of these control variables for the meaning of our trust variables. By effectively controlling for all investor and company country fixed effects, we immediately control for the overall level of trustworthiness (e.g., on average Swedes are trusted more than Spaniards). This means that our trust variables reflect relative trust (e.g., relative to the average level of trust, the Spanish are more trusted by the French than by the British). The country fixed effects also control for a host of other aspects of a country's legal and institutional environment. For example, in addition to having a common language (see discussion below), one may think that the level of a country's English language proficiency may matter. However, there is no need to control English language proficiency, since any such variation is already captured by the country fixed effects.

To provide a comprehensive picture of the effect of trust, we report the results of four regressions. We report results for both of our trust measures, recognizing that they capture different aspects of the distribution of trust: TRUST-PERCENTAGE focuses the right tail of the trust distribution whereas TRUST-LEVEL captures the average. For both measures of trust we then report results from two different model specifications: one without and one with the country-dyadic independent variables (DOMESTIC, INFORMATION, GDP-DIFFERENCE, COMMON-LANGUAGE and SAME-LEGAL-ORIGIN). The regressions without the additional country-dyadic results provide an understanding of the total effect of trust on the likelihood of investment. Obviously, we are also interested in disentangling to what extent the effect of trust can be explained by the other country-dyadic factors. We control for the amount of information that an investor is likely to be exposed to about other countries. Investments may be affected by the ease of structuring a deal and enforcing , so we control for common languages and whether the parties come from the same legal origin. Finally, the GDP measure account accounts for differences in the relative development of the two countries.

Let us be very clear about our reasons for including the additional country-dyadic factors. Guiso, Sapienza and Zingales (2005a) argue that factors such as having more information, or a common language are likely to foster trust. Indeed, they build a regression model for analyzing the determinants of trust, model that they subsequently use for identification to solve their endogeneity problem between trust and trade. In this paper we do not have their endogeneity problem, so there is no need to build a model of the determinants of trust. Instead, we can use trust as exogenously given, and analyze its effects on venture investments. Consequently, we do not include the additional country-dyadic factors because they might help to explain trust. On the contrary, the reason we include them is that each of our country-dyadic factors could affect venture investments directly, i.e., for reasons *other* than trust.

If anything, if the country-dyadic factors also affect trust, this may cause a multi-colinearity problem.[8] Table 2 shows the correlations among those variables. Multi-colinearity may reduce our coefficient estimates and lower our chances of finding a statis-

[8]Related to this, note that we do not use some of the country-dyadic factors that Guiso, Sapienza and Zingales (2005) use as determinants of trust, such as history of wars. We do this precisely because these variables should not have a direct effect on venture investments, i.e., the only reason they would matter is through trust. Including these variables would be conceptually incorrect and would worsen the problem of multi-colinearity.

tically significant relationship.[9]

3.2 Results

The results from our logit model are summarized in Table 3. The most important result concerns the effect of trust. In Table 3 we find that the coefficient on trust is positive and highly significant in three out of four regression. Even in the fourth regression the coefficient has the predicted (positive) sign with a z-score above 1 (the P-value is 0.17). These results support the hypothesis that trust affects the likelihood of making an investment.

Tables 4 and 5 report results from two further models which extend the analysis. The first extension considers further refining the company controls. With over one thousand companies in our sample we cannot add a fixed effect for every company. However, we can use a conditional logit specification (Chamberlain, 1980). This provides a semi-parametric estimation of the logit model, without need to estimate the individual company fixed effects. Our conditional logit specification effectively includes both investor and company fixed effects, thus providing the richest possible set of controls.

The second extension focusses on foreign deals. Our base model already controls for whether an investor and company are from the same country. This extension asks whether the results continue to hold if we exclude all domestic deals. To examine this we need to define the sample of potential foreign deals. We first eliminate all investors that only invest domestically (these observations would be dropped in any case from the regression because of the investor fixed effects). A question remains whether we should retain all companies, or only consider those companies that actually attracted a foreign investor. We adopt the latter approach, which is arguably more conservative and leaves us with the smallest, but possibly cleanest, sample of potential foreign deals. It leaves us with 224 deals in 217 companies, made by 47 venture capital companies, generating 8,327 potential deals. In unreported regression we also used the more inclusive approach and found very similar results.

The main results for trust in Tables 4 and 5 are quite similar to those in Table 3, suggesting that our findings are robust across specifications. The effects of trust in Table 4 are even stronger than in Table 3. In Table 5, the effects remain strong too.

In addition to the trust results, Tables 3, 4 and 5 contain several other interesting findings. First, we find that geographic distance is very important. The coefficient for distance has a negative sign and is statistically highly significant in all specifications. This confirms the notion that venture capital is a highly localized activity, and that investing at a distance is something that venture capitalists frequently avoid. This is an interesting result by itself.

A second interesting set of findings concerns the other control variables. The fact that being a domestic pair increases the likelihood of making an investment should not come

[9] In unreported regressions we further examined the issue of multi-colinearity. Using the data at the country-dyad level, we obtained the residuals from regressing our respective trust variables on the country-dyadic factors, as well as a complete set of giver and receiver country fixed effects. We then replaced our trust variables in the potential deals sample with those residuals, the idea being that the residuals capture that aspect of trust that cannot be explained by our country-dyadic factors. The results were qualitatively similar to the main regressions.

as a surprise, given the large literature on home bias. The information proxy is positive and (almost always) statistically significant. Even though this measure is only a rough proxy for differences in the amount of information actually available to investors, it proves to have significant explanatory power. In terms of the other country dyadic variables, we find that differences in GDP clearly matter for investment. Common language and same legal origin are insignificant in Table 3, although the legal variable becomes significant in Tables 4 and 5. Throughout all regressions we find that the industry and stage fit are highly significant, with the expected sign. This shows that specialization is an important aspect of the venture capital market, and to get an investment, companies need to fit in with an investor's strategic preferences.

3.3 Extensions and robustness

To validate the robustness of our results, we examine many extensions and alternative specifications. We consider various alternative sample definitions. For example, our sample contains some investments in US companies. Given the unique characteristics of the US (e.g., the greater distance, and the fact that it is the only non-European country), we reran our regression in the sample that excluded all US deals. The results were very similar, suggesting that our results are not driven by US companies. We also performed a similar exercise excluding all non-EU countries (i.e., Switzerland, Norway and again the US) and again found that this did not affect the results.

Theory provides only limited guidance as to what country-dyadic factors are likely to have a direct effect on venture investing (as opposed to an indirect effect through trust). Trade economist often consider it relevant whether two countries have a common border. While we cannot see a strong reason why this should matter for venture capital (which involves services, rather than physical goods), we examined nonetheless whether including a control for common borders affects the results, and found that it did not matter.

In unreported regressions we also further examined the issue of multi-colinearity. Using the data at the country-dyad level, we obtained the residuals from regressing our respective trust variables on the country-dyadic factors, as well as a complete set of giver and receiver country fixed effects. We then replaced our trust variables in the potential deals sample with those residuals, the idea being that the residuals capture that aspect of trust that cannot be explained by our country-dyadic factors. The results were qualitatively similar to the main regressions.

Our trust variables measure how much trust people in the investor's country have for people in the company's country. This means that we are looking at trust from the investor's perspective. Alternatively one may also take the company's perspective, looking at the trust people in the company's country have for people in the investor's country. Not surprisingly, the measures of investor and company trust are highly correlated, so that including both in the same regression would be meaningless. Instead, we reran all of our regressions substituting investor trust with company trust. We found that our results were qualitatively unaffected. This suggests that the results of trust do not depend on whether one focus on the investor or company perspective.

This section is still to be completed.

4 The role of trust for contracts

4.1 Methodology

A unique feature of our data is that it allows us not only to observe who invests in who, but also some detail about how the investment is structured. Section 2.3 explains the contractual measures used and what their rationale is. To analyze contracts, our unit of analysis is no longer the sample of all potential deals, but the sample of realized deals. This reduces the sample size to 1259 deals in 1198 companies, made by 109 venture capital firms. As usual with survey data, there are also some missing observations for each of the dependent variables. Except for INVESTMENT SHARE, the number of missing observations are relatively small.

Most of our dependent variables are binary, so that we use a logit model. The exception is INVESTMENT SHARE, which is a continuous variable, so that we use ordinary least squares regressions. Formally, our econometric specification is given by

$$Contract_p = \alpha + X_n'\beta_n + X_p'\beta_p + X_i'\beta_i + X_c'\beta_c + \varepsilon_p$$

where $p = (i, c)$ now index the *realized* investor-company pairs. The X vectors represents the same variables as in section 3, except that for the X_i' vector we use investor's country fixed effects, rather than investor fixed effects. We discuss this in section 4.3.. Again, we report the results for both TRUST-PERCENTAGE and TRUST-LEVEL, without and with dyadic controls. One word of caution: because the realized deal sample is made up of deals that were formed partly for their country-dyadic characteristics, the correlation of the country-dyadic variables is typically larger than those reported in Table 2. This means that the problem of multi-colinearity might be even stronger in here.

4.2 Results

Table 6 is comprised of three panels, that provide alternative ways of measuring the investor's reliance on other investors. In the majority of regressions, the trust variable has a positive and statistically significant coefficient. Even when insignificant at conventional levels, the coefficient typically remains positive with z-values well above 1. These regressions suggest that higher trust increases the investor's willingness to invest without relying on others.

Some control variables are also noteworthy. Having a language in common significantly increases the investor's willingness not to rely on others, an intuitive yet novel result in the literature. Another intriguing finding is that when the investor and the company come from the same legal system, syndication is more common. A possible reason is that other investors want to avoid investing when there are such legal complexities.

Turning to the financial structure, Table 7 shows that there is a clear relationship between trust and the use of securities that protect an investor in case of poor company performance. The coefficient of trust is consistently negative and statistically significant. The lower trust, the more investors rely on downside protection. This is an important result, as it demonstrates how contracts can be used to compensate for lack of trust.

Table 8 finally examines the adoption of contingent control clauses. The coefficient

of trust is always positive, and statically significant in three out of four specifications. This result may seem surprising at first. Unlike downside protection, contingent control rights are not used to make up for any lack of trust. Instead, this result suggests that the two parties are willing to use this type of contract if there already is a lot of trust. Note that contingent control rights are a sophisticated contracting tool that requires control to shift depending on a company's performance. Such sophistication may give rise to opportunistic behavior, such as by manipulating the underlying performance metric. Our results suggest that trust helps the two parties when contemplating the use of sophisticated contracting tools. Taken together, the results of table 7 and 8 show that the effect of trust can be subtle. Higher levels of trust not only reduce the need for protective clauses, such as downside protection, but also enable more sophisticated clauses, such as contingent contracting.

4.3 Extensions and robustness

We mentioned in section 4.1. that instead of using investor fixed effects, the analysis in the realized deals sample limits itself to investor's country fixed effects. The country fixed effects are by far the most important, since they allow us to focus on relative trust, and since they control for a large number of alternative explanations, such as differences in the countries' legal systems or other institutional factors. We don't take the additional step of using individual investor fixed effects because adding 109 fixed effects is too much for the smaller realized deals sample. Since there is not enough variation within deals by the same investor, the logit regression drops too many observations, which prevents us from estimating all the model coefficients. However, even if we are unable to use individual investor fixed effects, we can still control for additional investor characteristics. Building on our prior work, we considered three additional investor controls: the size of the venture capital firm, its age, and whether the venture capital firm is independent or captive (see Bottazzi, Da Rin and Hellmann (2005, 2006) for a detailed discussion of these variables). In unreported regressions we found that the results of Tables 6, 7 and 8 remain unaffected. This suggests that our results are not driven by investor characteristics.

This section is still to be completed.

5 Conclusion

Economists often distrust explanations that rely on subjective beliefs. Trust is a subjective belief. So is the economists' distrust of trust-based explanations! Hence the importance of empirically demonstrating the effect of trust.

This paper examines the effects of trust among nations in a micro-environment where endogeneity is not an issue. It finds that trust has a significant effect on the investment decisions of venture capital firms. These effects continue to hold even after controlling for a large number of alternative factors. Moreover, trust affects the contractual arrangements they use. Higher trust reduces the importance of protective clauses, and facilitates the use of more sophisticated contractual arrangements.

Analyzing trust at the micro-level constitutes a promising research agenda that might shed new insights into specific industries. It might also strengthen our understanding of

how these micro-level effects translate into relevant macro factors. Our analysis already hints at one such channel. Venture capital is inherently associated with the financing of innovation (Hellmann and Puri (2000), Kortum and Lerner (2000)). The new growth theory places innovation at the core of economic growth (Romer (1990)). If trust facilitates venture capital investments, them this may foster innovation and ultimately contribute to economic growth. More generally, exploring the micro channels through which trust can affect key economic transactions remains an important topic for future research.

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Table 1: Descriptive statistics

This table provides the mean, minimum and maximum values of our dependent and independent variables (we do not report these values of the investor and company nationality dummies, and for the industry dummies). For dummy variables we report the frequency of observations. Variables are defined in Section 2.

	POTENTIAL DEALS SAMPLE			REALIZED DEALS SAMPLE		
VARIABLE	Mean	Minimum	Maximum	Mean	Minimum	Maximum
Deal	0.011	0	1			
Trust-percentage	21.004	3	72	41.409	4	72
Trust-level	2.821	2.13	3.69	3.267	2.31	3.69
Domestic deal	0.104	0	1	0.823	0	1
Information	0.094	0	0.859	0.469	0	0.859
GDP Difference	4,660	0	34,352	1,077	0	25,546
Common Language	0.147	0	1	0.837	0	1
Same Legal Origin	0.291	0	1	0.872	0	1
Distance	6.720	0	9.322	3.762	0	9.176
Industry Fit	0.142	0	1	0.359	0.017	1
Stage Fit	0.509	0	1	0.705	0.048	1
Solo	–	–	–	0.338	0	1
Leader	–	–	–	0.581	0	1
Investment Share	–	–	–	0.576	0.001	1
Downside	–	–	–	0.447	0	1
Board Control	–	–	–	0.386	0	1
Number of observations	107,309			1,259		
Number of companies	1,198			1,198		
Number of venture firms	109			109		

Table 2: Correlations

This table provides pairwise correlations (and significance leveles, in brackets) among variables which vary at the country dyadic level. Variables are defined in Section 2.

	Trust Percentage	Trust Level	Information	GDP Difference	Common Language	Same Legal Origin
Trust Percentage	1.000					
Trust Level	0.8341 *(0.00)*	1.000				
Information	0.3233 *(0.00)*	0.2801 (*0.00)*	1.000			
GDP Difference	–0.2515 *(0.00)*	–0.3179 *(0.00)*	–0.2666 *(0.00)*	1.000		
Common Language	0.4095 *(0.00)*	0.3426 *(0.00)*	0.7040 *(0.00)*	*–0.3138* *(0.00)*	1.000	
Same Legal Origin	0.1901 *(0.0013)*	0.1024 *(0.0856)*	0.3430 *(0.00)*	–0.0596 *(0.2587)*	0.4711 *(0.00)*	1.000

Table 3
Potential deals sample. Dependent variable is DEAL
Logit regressions with investor fixed effects

This Table presents the results of logit regressions with investor fixed effects for the full sample. The dependent variable is DEAL. Variables are defined in Section 2. Company controls are complete sets of dummies for each company's country, industry and stage. Columns (i) and (ii) report results using the percentage measure of trust; columns (iii) and (iv) report results using the level measure of trust. For each independent variable, we report the estimated coefficient and the z-score (in parenthesis) computed using (Huber-White) heteroskedasticity-robust standard errors, clustered by country-dyad. Values significant at the 1%, 5% and 10% level are identified by ***, **, *.

	(i)	*(ii)*	*(iii)*	*(iv)*
Trust-Percentage	1.141***	0.043***		
	(8.06)	*(3.21)*		
Trust-Level			7.049***	1.227
			(7.27)	*(1.36)*
Domestic Deal		*1.414**		*2.347****
		(1.73)		*(2.77)*
Information		1.917**		1.252
		(2.33)		*(1.62)*
GDP Difference		–0.0001***		–0.0001***
		(–3.07)		*(–2.85)*
Common-Language		–0.043		–0.252
		(–0.07)		*(–0.39)*
Same Legal Origin		0.293		0.477*
		(1.03)		*(1.65)*
Distance	–0.298***	–0.223***	–0.302***	–0.224***
	(–3.46)	*(–2.80)*	*(–3.55)*	*(–2.82)*
Industry Fit	7.002***	6.929***	6.818***	6.900***
	(24.04)	*(26.42)*	*(23.71)*	*(26.56)*
Stage Fit	2.927***	3.014***	2.911***	3.002***
	(11.08)	*(11.93)*	*(11.01)*	*(11.78)*
Company Controls	Included	Included	Included	Included
Observations	107,309	107,309	107,309	107,309
Pseudo R^2	0.4849	0.5056	0.4851	0.5046
Number of venture firms	109	109	109	109
Number of companies	1,198	1,198	1,198	1,198

Table 4
Potential deals sample. Dependent variable is DEAL
Conditional logit regressions

This Table presents the results of conditional logit regressions for the full sample. The dependent variable is DEAL. Variables are defined in Section 2. Columns (i) and (ii) report results using the percentage measure of trust; columns (iii) and (iv) report results using the level measure of trust. For each independent variable, we report the estimated coefficient and the z-score (in parenthesis) computed using (Huber-White) heteroskedasticity-robust standard errors, clustered by country-dyad. Values significant at the 1%, 5% and 10% level are identified by ***, **, *.

	(i)	*(ii)*	*(iii)*	*(iv)*
Trust-Percentage	1.116***	0.039***		
	(20.55)	*(4.28)*		
Trust-Level			5.751***	1.303**
			(18.30)	*(2.47)*
Domestic Deal		0.99*		*1.753***
		(1.65)		*(3.04)*
Information		1.961***		1.316***
		(3.91)		*(2.92)*
GDP Difference		–0.0001***		–0.0001***
		(–4.24)		*(–4.03)*
Common-Language		–0.323		–0.506
		(–0.68)		*(–1.08)*
Same Legal Origin		0.498**		0.628***
		(2.40)		*(2.93)*
Distance	–0.492***	–0.399***	–0.510***	–0.403***
	(–17.16)	*(–13.33)*	*(–17.69)*	*(–13.33)*
Industry Fit	6.815***	6.692***	6.655***	6.672***
	(26.51)	*(26.32)*	*(26.74)*	*(26.44)*
Stage Fit	2.822***	2.928***	2.825***	2.926***
	(17.59)	*(17.60)*	*(17.70)*	*(17.54)*
Company Controls	Included	Included	Included	Included
Observations	107,309	107,309	107,309	107,309
Pseudo R^2	0.5876	0.6048	0.5901	0.6041
Number of venture firms	109	109	109	109
Number of companies	1,198	1,198	1,198	1,198

Table 5
Foreign sample. Dependent variable is DEAL
Logit regressions with investor fixed effects

This Table presents the results of logit regressions with investor fixed effects for the sample of foreign deals. The dependent variable is DEAL. Variables are defined in Section 2. Company controls are complete sets of dummies for each company's country, industry and stage. Columns (i) and (ii) report results using the percentage measure of trust; columns (iii) and (iv) report results using the level measure of trust. For each independent variable, we report the estimated coefficient and the z-score (in parenthesis) computed using (Huber-White) heteroskedasticity-robust standard errors, clustered by country-dyad. Values significant at the 1%, 5% and 10% level are identified by ***, **, *.

	(i)	*(ii)*	*(iii)*	*(iv)*
Trust-Percentage	0.024	0.052**		
	(1.17)	*(2.37)*		
Trust-Level			2.421**	1.975*
			(2.23)	*(1.88)*
Information		7.369***		5.151***
		(3.61)		*(2.74)*
GDP Difference		–0.00006		–0.00004
		(–1.34)		*(–1.02)*
Common-Language		–1.061		–1.381
		(–1.03)		*(–1.36)*
Same Legal Origin		1.113**		1.209**
		(2.09)		*(2.37)*
Distance	–0.416***	–0.224**	–0.387***	–0.271***
	(–4.37)	*(–2.57)*	*(–3.86)*	*(–2.91)*
Industry Fit	6.929***	6.829***	6.896***	6.819***
	(15.16)	*(15.68)*	*(15.20)*	*(15.96)*
Stage Fit	2.668***	2.760***	2.672***	2.751***
	(7.44)	*(7.47)*	*(7.40)*	*(7.37)*
Company Controls	Included	Included	Included	Included
Observations	8,327	8,327	8,327	8,327
Pseudo R^2	0.3049	0.3281	0.3100	0.3272
Number of venture firms	47	47	47	47
Number of companies	217	217	217	217

Table 6, Panel A
Realized deals sample. Dependent variable is SOLO
Logit regressions

This table presents the results of logit regressions for the sample of realized deals. The dependent variable is SOLO. Variables are defined in Section 2. Company controls are complete sets of dummies for each company's country, industry and stage. We also control of investor nationality. For each independent variable, we report the estimated coefficient and the z-score (in parenthesis) computed using (Huber-White) heteroskedasticity-robust standard errors, clustered by country-dyad. Values significant at the 1%, 5% and 10% level are identified by ***, **, *.

	(i)	*(ii)*	*(iii)*	*(iv)*
Trust–Percentage	0.026**	0.040		
	(2.30)	*(*1.18*)*		
Trust–Level			1.323**	2.160
			(2.12)	*(*1.59*)*
Domestic Deal		1.540		0.540
		(0.96)		*(0.46)*
Information		–1.495		–2.932*
		(–1.04)		*(–1.79)*
GDP Difference		0.0001**		0.0001**
		(2.28)		*(2.35)*
Common Language		3.994***		3.661***
		(4.40)		*(4.50)*
Same Legal Origin		–1.962***		–2.020***
		(–3.69)		*(–3.65)*
Distance	–0.010	–0.010	–0.011	–0.011
	(–0.39)	*(–0.38)*	*(–0.41)*	*(–0.39)*
Industry Fit	–0.390	–0.361	–0.388	–0.352
	(–0.73)	*(–0.67)*	*(–0.73)*	*(–0.65)*
Stage Fit	–0.337	0.334	0.344	0.333
	(–0.53)	*(*0.52*)*	*(*0.54*)*	*(*0.52*)*
Investor Nationality	Included	Included	Included	Included
Company Controls	Included	Included	Included	Included
Observations	1,120	1,120	1,120	1,120
Pseudo R^2	0.1016	0.1106	0.1015	0.1112

Table 6, Panel B
Realized deals sample. Dependent variable is LEADER
Logit regressions

This table presents the results of logit regressions for the sample of realized deals. The dependent variable is LEADER. Variables are defined in Section 2. Company controls are complete sets of dummies for each company's country, industry and stage. We also control of investor nationality. For each independent variable, we report the estimated coefficient and the z-score (in parenthesis) computed using (Huber-White) heteroskedasticity-robust standard errors, clustered by country-dyad. Values significant at the 1%, 5% and 10% level are identified by ***, **, *.

	(i)	*(ii)*	*(iii)*	*(iv)*
Trust–Percentage	–0.008	0.102**		
	(–0.73)	*(2.37)*		
Trust–Level			–0.164	4.599**
			(–0.39)	*(2.01)*
Domestic Deal		6.956***		3.914***
		(3.32)		*(3.05)*
Information		3.823**		0.321
		(2.41)		*(*0.20*)*
GDP Difference		0.0001		0.0001
		(1.42)		*(1.51)*
Common Language		4.925***		3.788***
		(3.90)		*(3.21)*
Same Legal Origin		–3.274***		–3.393***
		(–4.09)		*(–2.72)*
Distance	–0.042	–0.046*	–0.038	–0.045**
	(–1.62)	*(–1.81)*	*(–1.46)*	*(–1.76)*
Industry Fit	0.121	0.049	0.132	0.064
	(0.19)	*(0.07)*	*(0.20)*	*(0.10)*
Stage Fit	0.476	0.455	0.466	0.477
	(1.23)	*(1.18)*	*(1.20)*	*(1.23)*
Investor Nationality	Included	Included	Included	Included
Company Controls	Included	Included	Included	Included
Observations	1,029	1,029	1,029	1,029
Pseudo R^2	0.0983	0.1087	0.0980	0.1083

Table 6, Panel C
Realized deals sample. Dependent variable is INVESTMENT SHARE
Logit regressions

This table presents the results of regressions for the sample of realized deals. The dependent variable is INVESTMENT SHARE. Variables are defined in Section 2. Company controls are complete sets of dummies for each company's country, industry and stage. We also control of investor nationality. For each independent variable, we report the estimated coefficient and the t-score (in parenthesis) computed using (Huber-White) heteroskedasticity-robust standard errors, clustered by country-dyad. Values significant at the 1%, 5% and 10% level are identified by ***, **, *.

	(i)	*(ii)*	*(iii)*	*(iv)*
Trust-Percentage	0.005***	0.006*		
	(2.87)	*(1.78)*		
Trust-Level			0.248***	0.265
			(2.93)	*(1.53)*
Domestic Deal		0.435***		0.271**
		(2.83)		*(2.44)*
Information		0.021		–0.146
		(0.14)		*(–0.89)*
GDP Difference		0.00002***		0.00002***
		(2.95)		*(3.06)*
Common Language		0.698***		0.639***
		(7.27)		*(6.80)*
Same Legal Origin		–0.323***		–0.304***
		(–4.73)		*(–4.26)*
Distance	–0.001	–0.001	–0.01	–0.001
	(–0.35)	*(–0.27)*	*(–0.35)*	*(–0.29)*
Industry Fit	0.088	0.094	0.088	0.097
	(0.88)	*(0.95)*	*(0.87)*	*(0.99)*
Stage Fit	–0.073	–0.077	–0.068	–0.075
	(–0.79)	*(–0.83)*	*(–0.74)*	*(–0.81)*
Investor Nationality	Included	Included	Included	Included
Company Controls	Included	Included	Included	Included
Observations	755	755	755	755
R^2	0.1540	0.1753	0.1544	0.1750

Table 7
Realized deals sample. Dependent variable is DOWNSIDE
Logit regressions

This table presents the results of logit regressions for the sample of realized deals. The dependent variable is DOWNSIDE. Variables are defined in Section 2. Company controls are complete sets of dummies for each company's country, industry and stage. We also control of investor nationality. For each independent variable, we report the estimated coefficient and the z-score (in parenthesis) computed using (Huber-White) heteroskedasticity-robust standard errors, clustered by country-dyad. Values significant at the 1%, 5% and 10% level are identified by ***, **, *.

	(i)	*(ii)*	*(iii)*	*(iv)*
Trust-Percentage	–0.036***	–0.055**		
	(–3.23)	*(–2.29)*		
Trust-Level			–1.702***	–1.810*
			(–3.21)	*(–1.83)*
Domestic Deal		–1.083		0.276
		(–0.84)		*(0.29)*
Information		–1.526		–0.359
		(–1.49)		*(–0.32)*
GDP Difference		0.0007		0.00003
		(0.49)		*(0.21)*
Common Language		–0.228		0.263
		(–0.24)		*(0.30)*
Same Legal Origin		0.582		0.425
		(1.01)		*(0.69)*
Distance	–0.065**	–0.066**	–0.065**	–0.066**
	(–2.00)	*(–1.99)*	*(–2.00)*	*(–1.98)*
Industry Fit	0.678	0.729	0.690	0.708
	(1.17)	*(1.25)*	*(1.20)*	*(1.22)*
Stage Fit	0.413	0.386	0.388	0.373
	(1.26)	*(1.17)*	*(1.19)*	*(1.13)*
Investor Nationality	Included	Included	Included	Included
Company Controls	Included	Included	Included	Included
Observations	1,236	1,236	1,236	1,236
Pseudo R^2	0.1746	0.1765	0.1748	0.1757

Table 8
Realized deals sample. Dependent variable is BOARD CONTROL
Logit regressions

This table presents the results of logit regressions for the sample of realized deals. The dependent variable is BOARD CONTROL. Variables are defined in Section 2. Company controls are complete sets of dummies for each company's country, industry and stage. We also control of investor nationality. For each independent variable, we report the estimated coefficient and the z-score (in parenthesis) computed using (Huber-White) heteroskedasticity-robust standard errors, clustered by country-dyad. Values significant at the 1%, 5% and 10% level are identified by ***, **, *.

	(i)	*(ii)*	*(iii)*	*(iv)*
Trust-Percentage	0.049***	0.144***		
	(3.02)	*(3.08)*		
Trust-Level			1.757**	1.824
			(2.48)	*(1.02)*
Domestic Deal		–0.101		–4.271**
		(–0.06)		*(–2.59)*
Information		–1.849		–4.265**
		(–1.45)		*(–2.49)*
GDP Difference		–0.0008***		–0.0007**
		(–4.54)		*(–2.32)*
Common Language		–3.394***		–4.412***
		(–2.72)		*(–3.51)*
Same Legal Origin		0.790		1.599**
		(1.18)		*(2.03)*
Distance	0.036	0.030	0.027	0.027
	(1.09)	*(0.92)*	*(0.84)*	*(0.82)*
Industry Fit	0.672	0.601	0.651	0.678
	(0.59)	*(0.53)*	*(0.57)*	*(0.59)*
Stage Fit	1.285***	1.279***	1.309***	1.302***
	(3.10)	*(3.01)*	*(3.20)*	*(3.12)*
Investor Nationality	Included	Included	Included	Included
Company Controls	Included	Included	Included	Included
Observations	1,094	1,094	1,094	1,094
Pseudo R^2	0.1928	0.2048	0.1891	0.1986