

The Paradox of Shared Ownership: Investigating Board Member Roles in Start-Up Fraud Cases

Abstract

Research into venture fraud is still scant and there is limited insight for why and how it occurs beyond that the founding entrepreneur usually constitutes the main suspects. In this study, we examine the monitoring behavior of board members in start-up fraud and their potentially compromising relationships with the founding entrepreneur leading the venture. In contrast to emerging recommendations in the literature, our qualitative study of 14 prominent fraud cases exposes the limitations of shared stock ownership between founding entrepreneurs in the executive lead and board members. Whereas guidelines from previous work mostly related to agency theory suggest shared ownership should produce improved alignment with venture goals, we show this alignment mechanism indicates risk of monitoring failures and the perpetuation of insufficient supervision, enabling fraudulent activities among boards and CEOs. Furthermore, our model identifies the founding entrepreneur in the lead as a central issue, alongside a considerable risk of fraud reinforcement mechanisms. This risk is compounded by the tendency of board members to resort to ‘freeze’ or ‘flight’ responses as initial coping strategies when detecting fraudulent activities before confronting problems directly.

Keywords: alignment, monitoring, opportunism, venture boards, venture fraud, venture governance

INTRODUCTION

The Individual Defendants accomplished their conspiracy, common enterprise, and common course of conduct by causing the Company [sic] to purposefully or recklessly conceal material facts, fail to correct such misrepresentations, and violate applicable laws. The actions described herein occurred under the authority of the Board [of directors], thus each of the Individual Defendants [sic] who is a director of Nikola was a direct necessary, and substantial participant in the conspiracy, common enterprise, and common course of conduct complained of herein. (McKay and Fortunato, 2020, December 18)

Even though the study of venture fraud is a rather recent one, entrepreneurship scholars and practice have reported that specifically in venture contexts (i.e., ventures funded through venture capital) high uncertainties, resource dependencies, and information asymmetries may lead to deceptive behaviors and fraudulent activities by venture CEOs and top management teams (Palmer and Weiss, 2022; Vallaster et al., 2019). As such, those theorizing on principal agent¹ mechanisms corroborate that alignment between principals and agents in ventures decreases such risk, because few stakeholders, including venture CEOs and venture board members, share larger ownership stakes (Garg and Furr, 2017). Such investments lead to common interests and ventures are less likely to suffer from fraudulent activities (Krause et al., 2014), because “venture owners and investors constantly monitor and interact” leading to ventures that behave with integrity (Krause et al., 2014, p. 282).

Yet, despite the intuitive appeal that alignment is a solution to any agency problem, there may also be shortcomings of alignment to improve monitoring. In fact, while such theorizing suggests that board monitoring creates a perception of a scenario in which neither founders nor board members are inclined to engage in opportunistic behavior as it would jeopardize their investments (Jensen and Meckling, 1976), there is a larger debate about the mixed evidence of alignment (Garg and Furr, 2017; Knockaert et al., 2015; Krause et al., 2014; Zahra et al., 2009). Scholars have suggested that the varied evidence and inconsistent support for aligning stakeholder engagements by owners, boards, and top leadership primarily arise from a limited

understanding of board dynamics and of oversight activities within the boardroom. A multitude of social processes are involved in board decision-making, and factors such as being heavily invested in a venture—that is, having ‘skin in the game’—can significantly influence the psychology behind these decisions, potentially steering them towards individual opportunism (Lang and Wirtz, 2022; Yao and O'Neill, 2022). Lorsch and MacIver (1989, p. 95) elaborated upon the magnitude of dysfunction related to this issue when they described the boardroom process as “a charade of productive, problem solving ... [in which] important issues aren’t discussed openly.” Although the concept of alignment in boardroom dynamics is recognized, there is still limited understanding of its potential drawbacks, particularly concerning monitoring and its role in unethical behavior. Only a handful of studies (e.g., Finkelstein and Mooney, 2003; Sonnenfeld, 2002) have focused on this area of research, primarily examining the negative impact of boardroom politics on effective monitoring. However, these studies often overlook the ethical implications and the real risks of fraud that can arise from such dynamics.

Given the scant attention paid to the subject of venture boards, potential monitoring problems, and fraud we conducted a qualitative analysis of 14 venture fraud cases. We initially asked the following research question when we started the study: how do personal stakes interfere with the venture board’s monitoring and the mitigation of fraud in ventures? To our initial surprise, our qualitative analysis of these cases of venture fraud revealed a notable contradiction: although existing literature highly values monitoring, particularly in high-risk situations prone to venture fraud, we found several instances where, paradoxically, less monitoring occurred when it was most needed. Our findings demonstrate that it is not always beneficial for ventures when venture board members have ‘skin in the game’ and shared investments with the founding entrepreneur in the executive lead as often discussed by those proposing alignment in the agency theory paradigm (Bhagat and Tookes, 2012). Board members with stock ownership in the venture might neglect their monitoring responsibilities, choosing to overlook

venture fraud or its indicators. This behavior, whether passive or active, is often motivated by a desire to promote pro-organizational actions that maximize the venture's potential for success. We observed, when outsiders confront board members regarding venture fraud, board members used three response strategies – freeze, flight or fight. While freeze or flight strategies not only lead to board duty breach but also reinforce the opportunism through venture board monitoring—which then yields future venture fraud—the fight strategy illustrates turnaround moments in fraud cases where board members started to fight opportunism. Based on these findings, we develop a process model that present the issues around board member alignment and monitoring for venture fraud as well as the central role of the founding entrepreneur's opportunism in cases where fraud occurs.

We make two main contributions to agency theory and governance literature. First, we contribute to the agency discussion around the principal-principal problem in the board by extending the boundaries of agency theory and shedding light on the monitoring practices of venture boards, particularly within the context of venture fraud. Building upon prior work (Krause et al., 2014), our research emphasizes the importance of addressing the principal-principal problem in entrepreneurship, wherein both members of venture boards and founding teams hold significant stakes in their respective ventures, effectively making them principals (Garg & Furr, 2017; Krause et al., 2014). Previous research has not elaborated upon the risk for fraud and unethical behavior. We contend that the presence of shared investments and 'skin in the game' among venture board members introduces a potential high-risk situation, because when all principals have substantial financial investments in the venture, the oversight of board activities becomes challenging, making it difficult to effectively control and mitigate instances of opportunism. Our findings add a vital perspective to the principal-principal problem in that the CEO-board relationship and typical monitoring roles are compromised.

Second, research to date analyzing venture fraud focuses on the founding team rather than the venture board (see for example Brenkert, 2009; Griffith, 2016; Palmer and Weiss, 2022, Shepherd, 2019; Shepherd et al., 2022) and does not acknowledge problems arising from the board. However, the board is the primary governance mechanism of the venture and shares (legal) responsibilities for the founding entrepreneur's actions that can constitute venture fraud (Cable and Shane, 1997; Greve et al., 2010; Zahra and Pearce, 1989). Our insights contribute to the understanding of barriers of effective board monitoring beyond a CEO or top executive perspective (Bergh et al., 2019; Boivie et al., 2016) and caution recent suggestions of entrepreneurial governance innovations (Garg, 2020; Lang and Wirtz, 2022) as our findings suggest the benefits of board independence in ventures – that is, members without nested investment interests (Bruneel et al., 2022; Yao and O'Neill, 2022). These are important aspects to consider in the design of venture governance. We highlight a set of thought-provoking implications of how such governance may be executed to reduce risks of venture fraud.

THEORETICAL BACKGROUND

Monitoring is an important and effective mechanism used by the board of directors (board) to manage and lead a company. The board has the authority to recruit, dismiss, and provide remuneration to the management team but also the obligation to resolve conflicts of interest that may arise among decision-makers and residual risk bearers (Baysinger and Butler, 1985) and take corrective actions if needed (Garg, 2013). To meet its obligations to resolve potential conflicts of interests, act in the best interest of the company, and, therefore, prevent venture fraud, the board uses, among other things, varies monitoring practices. Monitoring practices are, for example, unit operator reporting and accounting practices, voting rules, grievance and arbitration procedures, notification requirements, and supervisory committees (Hart, 1995; Michael and Pearce II, 2004; Strebel, 2004; Weir and Laing, 2003).

However, despite the board's monitoring, some executives commit fraud. The new venture environment provides particular opportunities for engaging in venture fraud among the executive team, which mostly consists of the (co-)founders. This is because new ventures operate in an environment of high uncertainty (McVea, 2009), resource dependency (Hillman et al., 2009; Zhang et al., 2010) and information asymmetry (Griffith, 2016). Such an environment presents multitudinous situations in which the executive team has to decide to either engage in venture fraud, or not (Palmer and Weiss, 2022). The dilemmas arise especially in the interaction with stakeholders such as investors. To gain legitimacy among stakeholders and, therefore, ensure new or ongoing access to resources for venturing activities, and maybe act in the best interest of the venture (Lian et al., 2022; Tacke et al., 2022; Umphress and Bingham, 2011; Yu et al., 2020) some executives are tempted to engage in venture fraud such as getting involved in withholding critical negative information about their ventures from stakeholders (see Berrone et al., 2007; Dew and Sarasvathy, 2007) or committing fraud (such as data, scientific or wire fraud) (Palmer and Weiss, 2022).

The existing enticement for fraud in the entrepreneurial environment makes monitoring among ventures particularly important and a vital obligation of the venture board. Venture boards are boards of directors of new ventures. Research admits the importance of the venture board in the venture's success (Charas and Perelli, 2013; Garg and Furr, 2017) via its function as the major decision maker in the venture. Similarly to a corporate board, the venture board has authority over the venture's executive management appointment (Boeker & Karichalil, 2002; Wasserman, 2003), the ventures' strategy and innovation trajectories (Fried et al., 1998; Garg and Eisenhardt, 2017), the choice of investors (Bagley and Dauchy, 2012), and key operating procedures (Hellmann and Puri, 2002). Furthermore, the venture board is, as a corporate board, responsible for the venture executives' actions, including potential opportunistic behavior among venture executives that can lead to venture fraud (Greve et al., 2010; Zahra and

Pearce, 1989). To effectively carry out their obligations and responsibilities, make well-informed decisions, provide leadership to the venture, and prevent instances of venture fraud, venture boards require access to pertinent information. This information is typically acquired through the process of monitoring.

Although there are similarities between corporate boards and venture boards, there are also important differences (Garg, 2013, 2014). Entrepreneurship presents unique circumstances in agency theory (Garg and Furr, 2017) as “ventures with several owners are less likely to suffer agency problems” (Krause et al., 2014, p. 282). In contrast to public corporations where CEO misalignment is a classic agency problem, this issue is typically less critical in ventures (Arthurs and Busenitz, 2003; Garg, 2013). Given the early stage of new ventures, the assumption is that venture CEOs and boards are aligned in growing the venture’s valuation (Krause et al., 2014; Wasserman, 2017). Unlike in public companies, venture board members may own significant shares in the venture as early-stage investors (e.g., Business Angels and Venture Capitalists) and therefore possess significant knowledge about the venture’s sector (both being financially incentivized and field and knowledge experts). Therefore, the situation of venture CEOs and venture boards each owning significant stakes in the venture, has been referred to as a principal-principal rather than a principal-agent situation (Garg, 2014; Krause and Bruton, 2014). This motivates another dilemma where investor-directors who own “preferred shares” (with better terms and superior payoffs compared to common shares owned by others) (Fried and Ganor, 2006), might be more motivated to act in their own best interest rather than in the company’s best interest (Arthurs et al., 2008; Cable and Shane, 1997; Forbes et al., 2010; Gompers, 1996). Although we are gaining a deeper understanding of why venture board members behave opportunistically, we do not have a good understanding of how venture dilemmas influence the venture board’s monitoring and how the venture board can mitigate fraud in

ventures (Garg, 2014; Krause & Bruton, 2014). Against this backdrop, we ask: how do personal stakes interfere with the venture board's monitoring and the mitigation of fraud in ventures?

METHOD

Due to the limited understanding of venture fraud and the inadequate theoretical framework regarding board members' roles in venture fraud, we chose to conduct an inductive study. In keeping with an inductive case study approach (Yin, 2014), our goal was to theorize from an in-depth examination of boards of ventures committing venture fraud. Therefore, we started with an open mind but later in the coding discovered clear connections and insights to agency theory whereby we acknowledged those connections in the coding. To theorize on and establish a process model of venture boards, board member behavior, and venture fraud, we build generalizations out of the specific observations (Locke, 2001; Miles and Huberman, 1994; Strauss and Corbin, 1998). The chosen venture cases are extreme examples of a systematic problem within the startup environment – extreme cases are beneficial for using inductive methods to build theory or test for inadequacies in the explanatory power of existing theories (Bednar and Brown, 2023; Sala and Pratt, 2023; Siggelkow, 2007).

Data Sample and Collection

For the present study, we focused on ventures accused of fraud in the United States. We focused on young ventures (no more than ten years old and innovative in terms of their offerings or business model [Beckman et al., 2012; Hsu, 2008]) that are for-profit. Our data collection approach was to collect data from U.S. court cases against ventures and their founders. The found court data and corresponding ventures were screened and selected based on the aforementioned criteria (young, for-profit ventures). In doing so, we collected court documents from different ventures accused of fraud in the U.S. from 2002 to 2022. To gain a better understanding of what happened before, during, and after the court proceedings, we ensured that we collected extensive longitudinal secondary data from publicly available sources. In the end,

our secondary data included court documents such as, for example, defendants' answers to Securities and Exchange Commission (SEC) complaints, witness testimonials, exhibits, motions, as well as various published documents, articles and YouTube videos that portrayed actions by the venture board members and key executives (such as the founders and the CEO), prior, during and after the ruling was introduced. Our multiple data sources helped us reconstruct the happenings within the venture board of the researched ventures and answer the question: how venture dilemmas influence the venture board's monitoring and how the venture board can mitigate fraud in ventures.

Data Analysis

When analyzing the data, we followed the analytical process outlined by Pratt et al. (2006, look also at Crosina and Pratt, 2019), which comprised of open coding, axial coding, and theoretical coding. Although the coding process is described in a linear, stepwise manner, in practice, it was a more complex and iterative process. To ensure the validity of our results, we adopted an insider-outsider approach to coding interpretation and model building. This approach enabled the research team to utilize multiple perspectives in analyzing the data (Bartunek and Reis Louis, 1996). The data and coding were stored using Atlas.ti. In our study, we strategically selected 14 cases for analysis, as theoretical saturation (Aldiabat & Navenec, 2018; Saunders, et al. 2018) was achieved after examining 12 cases, but we included two additional cases to ensure the robustness and comprehensiveness of our findings.

Open coding. The purpose of this stage of our data analysis was to understand what happened in venture boards and how the venture boards and its members acted and reacted regarding the fraud committed by the ventures' CEO. Our initial coding of the data was descriptive and adhered to the words used in the data, as we wanted to portray an authentic rendition of what happened in the venture boards (Locke, 2001). At the beginning, for example, statements concerning the following were included in our open codes: missing compliance,

uncertainty among board members, authorization by the venture board, authorization for the venture, use of network by venture board members, no information shared, venture members went dark. In accordance with the qualitative practice in this stage of the analysis, we discerned a multitude of open codes through several iterations. Our inductive process necessitated revisiting the data, including the descriptive codes that were initially formulated.

As previously indicated, the coding process is characterized by an iterative rather than a linear progression. Consequently, as we oscillated between various coding steps, the labels underwent a process of evolution. For example, we started with an open code “no information shared”, using the language in the data. As we continued with the coding process, we gradually allocated an increasing number of textual segments (chunks) to this particular category. Nonetheless, we came to realize that the members of the venture board made distinctions between various facets of this information deficit as individuals. Consequently, we devised new open codes that could capture the subtleties of the information deficit that were deemed significant by the venture board members and therefore build new, more precise, open codes such as “no access to data or records” or “no requirement to gain data”. Subsequent to this open coding phase, we adopted an inductive approach to detect any discernible patterns that could suggest the presence of distinct subgroups within the sample. Although variations did exist across the venture board members, we did not identify any systematically different subgroups within the sample inductively. Indeed, despite the diversity of industries covered by the ventures in our sample, there was considerable consistency across most of the open codes in the sample.

Axial Coding. The second step involved axial coding to organize the open codes. In this step, the individual text segments of the open codes were grouped into more meaningful and comprehensive segments that represent abstract categories (Crosina and Pratt, 2019). This grouping process resulted in a shift to a higher level of abstraction, that is, from the text segments of venture board members’ statements to more theoretical categories. For example, we

abstracted *disinterest in critical reflection of venture action* from the open codes of “accepting own uncertainty regarding the inner workings of the venture,” and “accepting suggestions from the CEO without questioning.” Similarly, we abstracted *make false representation* from the open codes of “giving knowingly and intentionally incorrect information,” and “present fabricated financial information to stakeholder.”

Theoretical Coding. Using theoretical coding to analyze how the axial codes may or may not “fit together” to produce more abstract theoretical structures was the last step (even if it is an iterative process). These theoretical codes served as the cornerstone for creating a model that links them (see Charmaz, 2006). For example, we combined “make false representation,” “decide for the venture board,” and “forge venture board member’s compliance” to form *CEO’s opportunistic behavior*. Similarly, we combined “absence of leadership,” “imbalanced distribution of power,” and “majority of voting rights,” into *reasons for venture board’s lack of monitoring* on an organizational level. The data structure is shown in Figure 1.

Simultaneously, we started building a model to answer the research question in accordance with the iterative procedure mentioned above. The first author, who took on the position of the “insider,” first coded the data and then gave one of the coauthors, who assumed the role of the “outsider,” the basic data structure and model. The outsider forced the insider to consider alternative code configurations and model constructs. Using empirical trends in the data, the insider accepted some proposals and rejected others. For the accepted proposals and therefore the adjusted codes, the insider offered additional information to support particular theoretical codes or to show the mechanics underlying the proposed links between theoretical codes. Subsequently, the coauthor in the role of the outsider also assumed the role of the insider and together the two insiders presented the data to the third coauthor in the role of the new outsider, repeating the process just mentioned. This insider-outsider process helped to clarify and support the outcomes we now discuss.

Insert Figure 1 about here

THE REVEALING PATTERNS OF VENTURE CEO'S OPPORTUNISTIC BEHAVIOR DUE TO ABSENCE OF MONITORING

The reasons for the absence of monitoring by the venture board due to opportunistic behavior associated with the principal-principal problem also reveals a pattern of CEOs to behave opportunistically, which in turn evokes a certain reaction from the venture board and its members. We next discuss our model (see figure 2) that explains what process can occur when venture board monitoring in venture fraud cases is insufficient and what entities are involved in this process.

Insert Figure 2 about here

The Problematic Influence of Principal-Principal Alignment on Opportunistic Behavior

The findings show that in principal-principal alignment, problems with goals and protection from opportunistic interests arise and are highly influenced by *alignment through investments*, referring to the ownership stake of board members in the venture. Our findings reveal two impact factors of skin in the game; (1) stock ownership and (2) the board composition influencing how much 'skin in the game' the whole venture board holds.

Stock ownership. Stock ownership refers to the equity and options venture board members have of the venture. In some ventures, certain board members (mainly VC board members and founder board members) have a high proportion of the venture shares. Having a (high) stake in the venture brings (high) losses if the venture underperforms or even dissolves. Our data show that board member stock ownership is negatively related to performance of their

monitoring duties. For example, Laplace (a venture board member of the venture LendingClub) had an investment in one of the ventures investment funds (HYF) when the venture board approved improper adjustments to increase HYF's returns. Contrary to the disclosures in the Form ADV (Uniform Application for Investment Adviser Registration and Report by Exempt Reporting Adviser) Brochures, the venture did not restrict Laplanche's involvement in calculating the returns for the HYF or disclose its failure to do so. Each of the funds' adjustments that the venture board approved during the period Laplace invested in the fund, the CEO and the CFO kept the fund from reporting negative or near-zero returns.

Board composition. Board composition refers to the makeup of members that occupy positions on a venture board. This encompasses the type of individuals who fill board seats and the interdependence that exists between individual board members, the board itself, and the venture. A venture board is typically comprised of both inside and outside board members (Garg, 2013). Inside board members are often founder board members who simultaneously hold executive positions within the venture (Garg, 2013). In contrast, outside board members are those who do not hold executive positions within the venture, and may include investor board members, non-executive founder board members, and expert board members who possess industry-specific expertise and can provide the necessary competencies for the venture (Bagley and Dauchy, 2012; Garg, 2013). Our data indicate a significant association between the presence of inside board members, particularly in case of CEO duality, and higher levels of opportunistic conduct exhibited by the venture board. Furthermore, this relationship extends to the executive management of the venture and is a vital predictor of venture fraud. For example, Ray (appointed CEO of FTX Group for the bankruptcy chapter 11) states: "I think the lack of an independent board was a critical aspect of the [venture's] failure." (Ray, 2022, December 13) At FTX, the venture board was composed mostly by inside board members.

Stock ownership and board composition highly influence the opportunistic behavior exhibited by the venture boards and their individual members. Such behavior, in turn, can affect decision-making and involvement of individual venture board members, and ultimately, a lapse in the fulfilment of their monitoring activities. The subsequent sections will expound upon and these interrelated phenomena in greater detail.

Reasons for Venture Board's Absence of Monitoring

Reasons underlying monitoring failures due to opportunistic behaviors of the venture board is two folded. On the one hand, venture board's opportunism reflected in inadequate monitoring exists on an organizational level and, on the other hand, it exists on an individual level affected by the organizational level, both leading to a lack of monitoring. Our data reveals three distinct characteristics of board's opportunism in monitoring on an organizational level enabling CEO's opportunistic behavior; (1) the absence of leadership, (2) the majority of voting rights, and (3) the imbalanced distribution of power.

Absence of leadership. Absence of leadership refers to the venture boards missing leadership which is seen as boards operating without clear protocols. For example, the ventures under investigation have not established compliance programs or internal control systems to safeguard the company and/or to oversee the decisions made by the CEO. For instance, due to the absence of leadership, the venture board did not implement any governance structures in the venture as seen in this example:

“You know, to read the bankruptcy filing one gets the impression that FTX had the corporate governance of a college fraternity. In the bankruptcy filing you note that decisions about the disbursement of funds were made via an online chat with personalized emojis. And it seems to me corporate governance by emoji sounds like a recipe for the misuse of funds.” (Ray, 2022, December 13)

Majority of voting rights. Majority of voting rights refers to the extent of voting rights and control the board has in its decision-making and to influence the CEO. Voting rights are a critical aspect of corporate governance as they determine the extent to which investors and

founders can impact corporate decisions (van den Berghe and Levrau, 2002). Therefore, voting rights play a crucial role in determining the level of control that stakeholders have over a venture's decision-making processes (Cremers et al., 2017), which is also found in our data. For example: "The FTX Group's collapse appears to stem from absolute concentration of control in the hands of a small group of grossly inexperienced and unsophisticated individuals who failed to implement virtually any of the systems or controls that are necessary for a company entrusted with other people's money or assets." (Ray, 2022, December 13) Furthermore, our data show, that concentrated ownership structures, where a single investor or founder holds a majority of the voting rights, lead to a concentration of power and disinterest of the board for monitoring. For example, Bankman-Fried owned 90% of one of the four silos (Alameda) of the FTX group and, therefore, made the decisions for and controlled this silo. The distribution of voting rights is a critical factor in determining the balance of power and influence in a venture.

Imbalanced distribution of power. Imbalanced distribution of power refers to executive (founder) board members using their influence, status, and knowledge to become the venture's primary decision-makers. These board members become primary decision-makers due to the exploitation and navigation of the information asymmetry between inside and outside venture board members. Our data reveal that the venture board of the analysed ventures steeped in fraud consisted mainly inside board members. The venture boards with imbalanced distribution of power, where inside board members have higher power combined with the majority of voting right lead to a biased venture board, following venture board opportunism. For example, despite the common practice of founders experiencing dilution of their power due to multiple rounds of fundraising, Tetrick (founder of Hampton Creek) has been able to consolidate his power to such an extent that the venture board primarily serve in an advisory capacity, highlighting the imbalanced power distribution within the venture board.

In the analysed cases, it is also seen that inside board members appoint additional board members that are loyal to them or have existing dependencies. For example, Kalanick, former CEO of Uber, appointed Thain as Uber's board member "during a power struggle within Uber" (McElrath, 2020, January 13) as Kalanick thought Thain would be loyal to him. Another example is seen at Nikola as retaining control of Nikola was important to its founder Milton. For example, when a member of Nikola's venture board urged Milton to appoint additional independent members with public company experience to Nikola's board, Milton responded:

The most important [sic] is that I fully control the board at all times and have people who work well with my personality. No one sees the future like I do, and if you get too many world class brilliant people on the board, you will end up fighting over everything as they think they are the smartest in the room every time. (Milton, 2020, November 29)

The inside board members possess a greater amount of information pertaining to the venture than their outside board member counterparts – a situation which creates information asymmetry within the board. Consequently, this information asymmetry bestows a greater degree of power to the inside board members. Furthermore, the inside venture board members possess the discretion to determine which data they elect to disclose to and which to withhold from their outside board member counterparts.

Although organizational characteristics have a vital impact on venture board monitoring, individual opportunistic behavior is equally evident for influencing absence of monitoring. At the individual level, the data reveal that individual venture board members exhibit the following three reasons for their opportunistic-driven lack of monitoring: (1) disinterest in critical reflection of venture actions, (2) irresponsible inaction, and (3) limited effort to gain sensitive information.

Disinterest in critical reflection of venture actions. Disinterest in critical reflection of venture actions refers to the tendency of venture board members to accept their own uncertainty regarding the inner workings of the venture, and the consequent absence of questioning of

decisions made by the CEO. Our data reveal that, in certain instances, board members lack sufficient understanding or insight into the actions and decision-making processes of the venture CEO. Despite their awareness of this knowledge gap, they may display a passive disposition, failing to proactively seek additional information or clarification regarding the internal operations of the venture. Consequently, they passively accept the prevailing status quo without engaging in efforts to bridge the information deficit. For example, an investor board member missed an opportunity to question the soundness of a venture's forecasts and valuation estimations as he "never bothered to check to see if that was indeed a real [auditing] firm" (Fong, 2012, June 5).

Irresponsible inaction. Irresponsible inaction refers to the fact that venture board members fail to undertake appropriate measures to fulfil their obligations as they would not take on any responsibility in leading and overseeing the strategic direction or operations of the venture. For example, in connection with the absence of leadership, the ventures studied have not implemented compliance programs or internal control systems to protect the venture, and their board members also have not taken steps to assume responsibility for overseeing the CEO's decisions, as evidenced, for example, by the following statement (Ray, 2022, December 13): "Many of the companies in the FTX Group, . . . , did not have appropriate corporate governance. I [Ray] understand that many entities, for example, never had board meetings." Our findings indicate that the absence of sophisticated risk management systems in the ventures is indicative of the board members' irresponsible inaction. This is because board members neglect their duty to take on responsibility and commit to properly manage the venture's compliance as seen in the case of Nikola Corporation.

In violation of the Audit Committee Charter, and their general duties (the Company's [sic] Audit Committee is specifically tasked with the Board's [sic] oversight responsibilities) as members of the Audit Committee, the Audit Committee Defendants conducted little, if any, oversight of the Company's [sic] internal controls or the Company's [sic] compliance with legal and regulatory requirements, resulting in materially false and misleading statements regarding the Company's [sic] business, operational,

and compliance policies, and consciously disregarded their duties to monitor such controls over reporting. The Audit Committee Defendants' complete failure to perform their duties in good faith resulted in false misrepresentations to the SEC, the investing public, and the Company's [sic] stockholders. (McKay and Fortunato, 2020, December 18)

Irresponsible inaction, disinterest in reflecting upon actions taken, and the imbalanced power distribution in the venture board are interconnected. Some board members had limited power and influence within the board, which decreased their interest in scrutinizing the actions taken by the CEO and fulfilling their responsibilities as board members. For example, venture board members of Zenefits were cognizant of the fact that certain employees within the organization were engaging in insurance brokerage activities without possessing the requisite licenses. Rather than taking proactive measures to rectify this compliance issue, the board members opted to accept and accommodate this breach of regulatory requirements. (Vullo, 2017)

Limited effort to gain sensitive information. Limited effort to gain sensitive information refers to venture board members not taking action to gain access to data or records about potential destructive venture directions or intervene in the venture's lack of record keeping. For example, as the Nicolas highest officer, Russell, "conducted little, if any, oversight of the Company's [sic] engagement in the scheme to make false and misleading statements, consciously disregarded his duties to monitor such controls over reporting and engagement in the scheme, and consciously disregarded his duties to protect corporate assets." (McKay and Fortunato, 2020, December 18)

Furthermore, limited effort to gain sensitive information is closely associated with irresponsible inaction, disinterest in critical reflection of venture action, and imbalanced voting power. The data show, that board members with little or no voting power did not request information regarding internal controls or governance. Furthermore, members with disinterest in the venture's action and with no sense of responsibility towards board duties did not show any indication of effort to gain access to information about the venture. For example, Ray testified

that FTX had a lack of record keeping and “there’s a whole lot of financial statements that are either not audited or not available.” With no records or financial statements, the venture board has no basis to discuss strategic decision making.

As the venture board itself, depending on its skin in the game, and the individual venture board member’s opportunistic goals tend to scale the venture and get the maximum out of it, board members reduce their monitoring duties and leave the decisions and business activities to the CEO, even accepting venture fraud when needed for a pro-organizational manner when it yields higher venture standing. The opportunistic behavior of the venture board and its members is seen in the following quote: “All of the Directors [sic] benefitted directly from the wrongdoing alleged herein, as the false and misleading statements caused the Company’s [sic] stock price to be artificially inflated, thus increasing the value of Nikola stock and RSUs held by the Directors [sic] pursuant to the 2020 Plan.” (McKay and Fortunato, 2020, December 18)

Enabling of CEO’s Opportunistic Behavior

The lack of venture board monitoring allows for the exploitation of venture fraud such as information asymmetry and moral hazard, which is when the CEO (1) makes false representations, (2) makes decisions for the venture board, and (3) forges the venture boards compliance and agreement.

Make false representations. Make false representations refers to the CEO knowingly giving incorrect information, statements, and representations to, not only, the venture board, but also (potential) investors, (potential) business partners, and/or (potential) customers. The CEO does so by falsifying documents or telling lies, to gain legitimacy and trust of the stakeholders, to, in the end, present the venture as prosperous and gain resources for the ventures’ growth (Baron et al., 2015; Baron et al., 2018; Überbacher, 2014). For example, the CEO of Exit 7c (Frohling, n.d., p. 2) “made materially false representations and statements to investors and potential investors regarding Exit 7c’s revenue, profits, growth, volume of business, and

overall financial performance. Egbon [CEO] supported those misrepresentations and false statements with false and fraudulent documents, including profit-and-loss statements, balance sheets, income statements, tax documents, and bank statements.”

Decide for the venture board. Decide for the venture board refers to the phenomenon of the CEO unilaterally making decisions that should rightfully fall within the purview of the venture board. This occurs due to the CEO’s failure to consult the board before making such decisions or, in some cases, even resorting to forging documents and signatures of venture board members. Such behavior is mainly seen when the venture’s CEO is also a member of the venture board.

For example, “by 2010, MDO [a financial technology company] needed cash: it was not producing revenue and had lost its largest investor. In August 2010, a new investor invested \$2.5 million in MDO, in exchange for a 15.6% share of the company (based upon a total valuation of \$13.5 million, as approved by MDO’s Board of Directors [sic]). A portion of MDO’s remaining equity was owned by Affinity Holding, which in turn was owned by various persons and entities including Mozido Investments (a Liberty-controlled shell entity) and BRTMDO [an investment company]. At the time of the investment, MDO executed an ‘Amended and Restated Limited Liability Company Agreement’ (Amended Operating Agreement). Liberty agreed to MDO’s Amended Operating Agreement and personally signed on behalf of Mozido Investments, BRTMDO, and himself.” (Jones et al., 2018, March 30, pp. 9–10)

Another example of how the lack of monitoring enables a CEO’s opportunistic behavior and leads to venture fraud is seen in the statement of Ray when explaining the internal failures and the inadequate policies that occurred which led FTX to engage in fraud and collapse at the end:

“You know, it’s virtually unlimited in terms of the lack of controls, no centralized records on banking, no daily reconciliations of crypto assets, silos where there’s no insurance, inadequate insurance, no independent board. No safeguards that limit, who controls an asset. So senior management literally could get access to any of the accounts in any of the silos. . . . It’s virtually unlimited in terms of the lack of control.” (Ray, 2022, December 13)

Forge the venture boards compliance/agreement. Forge the venture boards compliance/agreement refers to the CEO making incorrect representations to the board or outsiders and forging the board’s agreement. Our data show that CEOs made false representations to

outsiders disguising the board's lack of knowledge of their statements. For example, MDO Investments' venture board valued the venture at no more than USD 16 million in September 2010, however MOD's CEO told prospective investors that the "shares" of "of Mozido Investments were valued at \$55 million and that the 'private round of money raising (pretty much all by me)' put the value of MDO "closer to \$85 million."

Another example of a forged board agreement is seen in the case of Bouxtie:

Libric [CEO of Bouxtie] provided to Moose Run, LLC [a Wyoming Limited Liability Company] a forged, Docusigned [sic] entirely by [Moose Run, LLC], Corporate Resolution from the Board of Directors [sic] approving Moose Run, LLC's investment. Thereafter, Libric represented that the Series B [investment round] had closed and sent Moose Run, LLC an authorized stock certificate for 947,059 shares of Bouxtie, Inc. While the stock certificate is valid, signatures are forged, and the issuance was never authorized. Bouxtie's Board of Directors [sic] was not aware of any part of this investment transaction. (Kravitz and Albright, 2019, April 8, p. 4)

Venture Board's Reaction to Fraud

As soon as outsiders, such as investors observed signs of fraud occurring in the venture, they started to ask clarification questions because they were concerned about losing their money or reputation. The raised concerns evoked certain reactions of the venture board and its members. The venture board members responded with either (1) freeze, (2) flight, or (3) fight. With the first two strategies, venture board members breached their board duties. Furthermore, those strategies reinforce the opportunistic behavior of the board and its members as well as the opportunistic behavior of the CEO.

Freeze. Freeze refers to a passive response, whereby venture board members refrain from taking action or intervening in the face of fraud. Our data show that venture board members go dark and start ignoring the fraud happening in the venture when concerns are raised by stakeholders. This reaction is highly linked to the venture board's opportunism at the individual level as they are disinterested in reflecting on venture action, get access to sensitive information or take on responsibility to resolve potential fraud. For example, in 2014, the chief strategy officer appointed by Hampton Creek, a venture in the FoodTech industry, departed from his

position merely nine days after assuming the role. The executive expressed personal concerns regarding the venture's activities, specifically highlighting the potential exposure to legal action for fraud. Consequently, he took it upon himself to notify the external members of the venture board about the alleged fraud perpetrated within the venture. Despite these grave concerns, the board members collectively decided that the situation did not warrant further action or intervention.

Furthermore, our data reveal that some venture board members refuse to engage with the venture's stockholders or respond to their concerns, when they start asking reasonable questions regarding any potential fraudulent activities. Furthermore, some board members may possess knowledge of the venture's involvement in fraudulent activities but fail to intervene. For instance, certain board members of Zenefits were aware of compliance failures but chose not to take any action (D 910).

Interviewer: “There was elements of that that was known to the board, right? And there was some stuff that was, you know, people kind of knew that; hey these people were licensed in some states but not the other and we [meaning Zenefits] probably have to pay a fine for it but –. There was level of – it wasn't you were hiding this from the entire company or something?” **Conrad:** “No!” (The Logan Bartlett Show, 2022, June 1)

Flight. Flight refers to venture board members distancing themselves from the venture, abandoning their monitoring responsibilities, and severing ties with the venture entirely. Our data reveal that venture board members, usually the ones with little skin in the game, resign from the venture board. These resignations took place as soon as investors started asking uncomfortable but legitimate questions about potential fraud committed by the venture. For example, “a number of Trustify's board members have suddenly resigned and one has even retained separate counsel.”

These two strategies (freeze and flight) reinforce the CEO's opportunistic behavior and therefore venture fraud.

Fight. Fight refers to the venture board and its members taking actions to prohibit further fraudulent activities committed by the venture. It is the only strategy where the venture board and its members suppress the CEO's opportunistic behavior, fulfilling their fiduciary and board duties and thereby initiate a turnaround toward effective and appropriate agency monitoring. The venture board does so by appointing a new CEO and replacing other fraudulent executives (and venture board members), building a compliance team and program, strengthening the monitoring of the startup, reconstituting the venture board so that it is no longer controlled by fraudulent executives (2/3 of the voting seats are not held or controlled by executive managers) and/or using outside auditors. Furthermore, our data reveals that the ventures that initiated a turnaround and are still operating built a compliance team and program and introduced venture board monitoring. For example, "In March 2020, the company's (HeadSpin) Board of Directors was alerted to concerns about the accuracy of the financial and customer information provided to investors and discovered, through an investigation, significant issues with HeadSpin's reporting of customer deals. HeadSpin then determined, based on a subsequent review of its financial information, that HeadSpin's ARR at the end of 2019 was closer to \$10 million, as opposed to the \$80 million represented to investors. In May 2020, HeadSpin forced Lachwani to resign."

DISCUSSION

Our study makes several advancements to previous research. Through our reliance on a unique dataset, we demonstrate valuable theoretical insights at the intersection of venture governance and the principal-principal problem (Garg & Furr, 2017; Krause et al., 2014). Additionally, our findings advance agency theory by elucidating the intricate dynamics within venture boards and the CEO-board relationship. Moreover, our research takes a novel approach by redirecting the focus from founders and venture fraud to the venture board and venture fraud. Finally, this study also suggests implications on practical fraud prevention and suggests new

directions for future research. We now turn to the theoretical contributions, practical implications, and limitations and possible research directions.

Contribution to Agency Theory and Venture Governance Literature

Our research contributes to agency theory and venture governance literature in several ways. First, our study challenges the conventional wisdom that emphasizes the benefits of venture board members possessing a significant personal stake in the venture, often referred to as ‘skin in the game’. Existing literature widely supports the idea that venture board members and founders should have a personal stake in the venture (Bhagat and Tookes, 2012; Krause et al., 2014). The argument presented here is that aligning the interests of principals and agents in ventures significantly reduces the risk of venture fraud, according to those who theorize on principal-agent mechanisms. This alignment is especially noticeable when stakeholders, such as venture CEOs and board members, hold larger ownership stakes. Garg and Furr (2017) argue that such investments create common interests, which can reduce the likelihood of fraudulent activities within the venture. Additionally, shared stakes lead to regular monitoring and interaction between venture owners and investors, creating an environment that promotes greater integrity (Krause et al., 2014). However, our analysis challenges the prevailing assumption that greater personal investment leads to enhanced monitoring and oversight. Our findings reveal that monitoring fails when it is expected to be the most effective due to high levels of personal investment among venture board members.

In cases involving venture fraud, where vigilance should be paramount, venture board members with substantial personal investments may neglect their monitoring responsibilities. This behavior is motivated by the desire to promote pro-organizational behavior and maximize the success of the venture. The phrase ‘skin in the game’ emphasizes the potential conflict of interest between personal gain and monitoring responsibilities, especially when venture board members have a significant financial stake in the venture. This perspective contributes to a

comprehensive understanding of the dynamics within venture governance and the challenges of aligning individual incentives with the venture's best interests.

Second, although it is widely believed that aligning the interests of founders and board members is a panacea for agency problems, the effectiveness of such alignment in enhancing monitoring warrants a more nuanced examination. Theoretical perspectives, such as those proposed by Jensen and Meckling (1976), suggest that board monitoring creates a scenario in which neither founders nor board members are likely to engage in opportunistic behavior, thus safeguarding their investments. However, the concept of alignment is contested due to conflicting evidence (Garg and Furr, 2017; Knockaert et al., 2015; Zahra et al., 2009). The support for stakeholder engagement alignment, involving owners, boards, and top leadership, may stem from a lack of understanding of board dynamics and an oversight of activities within the boardroom. Several scholars argue that decision-making processes are heavily influenced by social factors and psychological biases. For example, being significantly invested, or having a personal stake, might skew decision-making towards individual opportunism (Lang & Wirtz, 2022; Yao & O'Neill, 2022). Therefore, the complexity and political dynamics of boardroom interactions can hinder effective monitoring. Our study sheds light on this limited research field (Finkelstein & Mooney, 2003; Sonnenfeld, 2002) by demonstrating the negative consequences of board members' ownership stakes on monitoring effectiveness and ethical violations.

Third, our study contributes to the agency theory discourse by highlighting the principal-principal problem in venture board governance, a topic that has been underexplored in the entrepreneurship literature (Garg & Furr, 2017; Krause et al., 2014). Our research expands the scope of agency theory and sheds light on the complexities of monitoring practices within venture boards, particularly in the context of venture fraud by focusing on the unique dynamic where both venture board members and founding teams hold substantial stakes, positioning them both as principals. This scenario raises the principal-principal problem, particularly in the

realm of entrepreneurship (Krause et al., 2014). The study's findings suggest that the financial involvement of venture board members and founders does not mitigate the monitoring problem, contrary to earlier assertions. We argue that the phenomenon of 'skin in the game' among board members may actually increase the risk of venture fraud. This risk is amplified when all principals have significant financial stakes, as it complicates the effective monitoring of board activities and impedes the control and mitigation of fraud. The principal-principal problem, which can be intensified by significant investments from multiple parties, presents a notable risk. This adds a critical perspective to the understanding of venture board dynamics and governance challenges. Our study emphasizes the necessity for well-thought-out governance mechanisms that strike a balance between aligning interests and ensuring independent monitoring which is essential for preventing and addressing venture fraud.

Finally, our research underscores the existence of a vicious cycle in which the opportunistic behavior of venture board members influences a corresponding opportunistic response by the venture executive management, thereby eliciting specific actions on the part of venture board members. The existing literature highlights a vicious cycle, primarily emphasizing the role of venture capitalists. The argument centers on how venture capitalists significantly shape this cycle given their focus on value creation and specifically maximizing financial gains (Gompers and Lerner, 2004). In contrast, ventures rely on resources provided by investors and face pressure to achieve established goals (Pfeffer and Salancik, 1978), highlighting tensions between investor and venture objectives (Waldron et al., 2022; Zhang et al., 2011). However, our data reveal that venture board members also influence executive opportunistic behavior. Due to the opportunistic tendencies, board members tend to limit their monitoring responsibilities, thereby enabling executive management's opportunistic behavior. Reduced board monitoring capacity increases the potential for exploitation of information asymmetries and moral hazards, ultimately leading to venture fraud.

Contribution to Venture Fraud Literature

Our research presents a new perspective by shifting the focus from founders (Kuratko et al., 2020; Pollack and Bosse, 2014; Rutherford et al., 2009; Theoharakis et al., 2021) to the venture board in relation to venture fraud. This approach provides a fresh view of the potential emergence of venture fraud in the realm of venture governance. The change in focus requires a reassessment of the duties and obligations of venture boards in preventing and addressing fraudulent activities, thus, providing a new lens through which to examine this issue. Understanding venture fraud requires a shift in focus because the current literature on the subject primarily concentrates on the actions of founders, excluding other relevant parties. Previous research has highlighted the dilemmas faced by ventures and their founders potentially leading to venture fraud (Brenkert, 2009). Additionally, the current literature has explored the potential association between founders and venture fraud (Kuratko et al., 2020; Pollack and Bosse, 2014; Rutherford et al., 2009; Theoharakis et al., 2021) by pointing to certain personal motives of founders as driving venture fraud (Brownell et al., 2021; Yu et al., 2020).

While we concur with these studies, our research posits that the inherent uncertainty surrounding ventures places board members with ‘skin in the game’ at high risk if venture fraud occurs within their purview. Our findings reveal a neglect of monitoring practices within ventures due to venture board members ‘skin in the game,’ which can result in venture fraud. This lack of monitoring can be caused by opportunistic behavior by both the board as a collective entity and its individual members. Venture boards are confronted with ongoing dilemmas as they strive to balance the imperative of acting in the best interests of the venture (Pan, 2009) while simultaneously adhering to legal and ethical norms (Brenkert, 2009). Faced with these dilemmas, the board must navigate trade-offs between maximizing the venture’s potential for success, which may involve opportunistic behavior, and mitigating potential risks such as reputational damage or legal implications (for a recent review on these board service tasks see

Åberg et al., 2019). The significant financial investments of venture board members contribute to this dynamic. Consequently, depending on the exploitation of venture boards' opportunism, the fulfillment of monitoring duties may be compromised. These mechanisms can facilitate the perpetration of venture fraud within the CEO-board relationship by individual venture board members' flight or freeze strategies because of conflicting interests.

Practical Implications

In addition to the theoretical contributions, this study provides practical insights for organizations and practitioners. Our study shows that 'skin in the game' among venture board members – in venture fraud cases – critically influences the monitoring duties of the venture board and the likelihood of venture fraud. This influence operates through a cycle of opportunistic behavior by venture board members and CEOs, with the former decreasing their monitoring duties in order to facilitate the latter's fraudulent pro-organizational behavior. For example, as venture board members with 'skin in the game' tend to facilitate faulty pro-organisational behavior by decreasing their monitoring duties, which is seen as disinterest in the critical reflection of the venture's actions, they also enable CEO's opportunistic behavior. When venture board members are confronted with the venture's fraud, they either freeze (by going dark or ignoring venture fraud), flight (by resigning from the board or hiding behind lawyers), or fight (activating their monitoring duties and intervening against venture fraud).

To break this cycle of opportunistic behavior, we suggest the introduction of regulations or best practices at three levels: the process level, the organizational level, and the outside level. At the process level, we advocate the implementation of executive sessions and a contingency plan. Executive sessions are intended to be exclusive meetings of non-executive board members. During these sessions, non-executive members can freely discuss and evaluate the performance of the executive team without any influence from executive members. The purpose of these sessions is to encourage thorough preparation, analysis, and unbiased discussion

among non-executive board members. To ensure that board members have unfettered access to essential information and data, even in cases of sudden executive departures, a well-defined contingency plan should be in place. These measures aim to prevent opportunistic monitoring behaviors not only at the process level but also at the organizational levels, promoting a more balanced power distribution and encouraging critical reflection on corporate actions.

At the organizational level, we propose the implementation of discipline regulations, such as a “duty to be active” for all venture board members. This rule would mandate board members to actively engage in meeting preparations, comprehensive reporting, questioning, and discussions during board meetings. Such active involvement would naturally enhance oversight and mitigate the tendency to adopt a passive stance in the face of irregularities.

At the outside level, we advise outsiders to be cautious and distinguish cosmetic venture boards from successful ones, and to question ventures that seem “too good to be true”. Outsiders might be warned to look out for cosmetic venture boards – those that look good from the outside but lack the necessary expertise to serve the venture board effectively.

Limitations and Future Research Directions

Although this study advances our understanding of the venture board’s impact in venture fraud, it does have limitations. First, we focused only on venture fraud cases. Looking at established companies, they tend to have more public scrutiny (Gamez-Djokic et al., 2021) and are more regulated than ventures, indicating that venture boards have more freedom in (not) following their board duties. Future research could provide further insights into the governance dynamics in different organizational contexts and the factors that influence board behavior, such as the exposure to the public, board member prestige, or different kinds of governance regulations.

Second, our findings indicate that venture board members with personal investments ('skin in the game') may be more inclined towards opportunistic behavior. We examined the roles of these members across various ventures to investigate if further fraud was observed. The stories in the accounts and the fact that past criminal behaviour was not mentioned in these cases supports that opportunism is something that can generally occur within the new venture context. Our analysis does not specifically account for the social or psychological factors of board members or the broader ecosystem these board members were involved, which could influence their involvement in fraudulent activities. This omission suggests a need for further research into the personal attributes of board members and cultural contexts that might predispose them to such behavior.

Third, our data sources are derived from court cases, which are inclined towards opportunistic examples and instances of violation. While these limitations are well-suited for the objectives of our paper and the model we present, they do impose certain constraints. We recognize that there is a bias to the concepts identified in the model. Even though we believe this is an advantage, future studies could benefit from studying grey cases (that is, cases suspicious of fraudulent activities) or cases where fraud has not occurred and further establish if alternative explanations could be identified.

Fourth, our study focuses on secondary data which can have the bias of retrospective views. Even though most of the data are from courts, generated under oath, they still represent retrospective views and as such run the risk of having been assembled in such a way that they yield the main mechanisms elaborated upon in the data. To reduce the risk of retrospective bias, we added real-time data (e.g., e-mails, YouTube videos) either presented at the trial or during the time the venture was active and not indicted to minimize any biases. We also believe that the focus of the data and how it is naturally biased to opportunistic examples and examples of violations, should rather mitigate the influence of such bias because of court scrutiny.

Finally, our model and study investigate the origin of the opportunistic problem and the reasons for venture fraud in new venture boards. For future research endeavors, we recommend a closer examination of strategies aimed at preventing venture fraud. Specifically, we suggest sampling from risk situations that are conducive to the execution of fraudulent activities. By focusing on these contexts researchers can gain valuable insights into the underlying dynamics and develop more effective strategies to mitigate fraud risks.

CONCLUSION

We conducted a qualitative study to elaborate theory on venture board monitoring, which required us to understand how venture dilemmas influence board monitoring and how boards can mitigate venture fraud. As a result, it became apparent that a lack of venture board monitoring enabled CEO's opportunistic behavior evoking specific strategies by individual venture board members. The main message of this study is that 'skin in the game' by venture board members might not be as good as it seems, regarding venture board monitoring and preventing venture fraud. The findings of the current study provide a new theoretical understanding of agency theory in venture organizations, an understanding that highlights some of the significant mechanisms in the formation and persistence of venture fraud, which in turn provides insights into the formal and informal aspects of board governance.

Notes

¹ Agency theory is a theoretical framework in corporate governance research that explains how the separation between ownership and control can lead to conflicts of interest between managers (agents) and shareholders (principals) (Berle and Means, 1932); managers may prioritize their own interests over those of the shareholders (Fama, 1980; Jensen and Meckling, 1976).

References

- Arthurs, J. D. and Busenitz, L. W. (2003). 'The Boundaries and Limitations of Agency Theory and Stewardship Theory in the Venture Capitalist/Entrepreneur Relationship'. *Entrepreneurship Theory and Practice*, **28**, 145–62.
- Arthurs, J. D., Hoskisson, R. E., Busenitz, L. W. and Johnson, R. A. (2008). 'Managerial Agents Watching Other Agents: Multiple Agency Conflicts regarding Underpricing in IPO Firms'. *Academy of Management Journal*, **51**, 277–94.
- Åberg, C., Bankewitz, M., & Knockaert, M. (2019). Service tasks of board of directors: A literature review and research agenda in an era of new governance practices. *European Management Journal*, **37**(5), 648–663.
- Bagley, C. E. and Dauchy, C. E. (2012). *The Entrepreneur's Guide to Business Law*, 4th ed. Mason, Ohio: South-Western.
- Baron, R. A., Tang, J., Tang, Z. and Zhang, Y. (2018). 'Bribes as Entrepreneurial Actions: Why Underdog Entrepreneurs feel Compelled to use them'. *Journal of Business Venturing*, **33**, 679–90.
- Baron, R. A., Zhao, H. and Miao, Q. (2015). 'Personal Motives, Moral Disengagement, and Unethical Decisions by Entrepreneurs: Cognitive Mechanisms on the "Slippery Slope"'. *Journal of Business Ethics*, **128**, 107–18.
- Bartunek, J. M. and Reis Louis, M. (1996). *Insider/outsider team research*. Thousand Oaks, Ca: Sage.
- Baysinger, B. D. and Butler, H. N. (1985). 'Corporate governance and the board of directors: Performance effects of changes in board composition'. *Journal of Law, Economics and Organization*, **1**, 101–24.
- Beckman, C. M., Bird Schoonhoven, C., Rottner, R. M. and Kim, S.-J. (2014). 'Relational Pluralism in De Novo Organizations: Boards of Directors as Bridges or Barriers to Diverse Alliance Portfolios?'. *Academy of Management Journal*, **57**, 460–83.
- Bednar, J. S. and Brown, J. A. (2023). 'Organizational Ghosts: How "Ghostly Encounters" Enable Former Leaders to Influence Current Organizational Members'. *Academy of Management Journal*.
- Bergh, D. D., Ketchen, D. J., Orlandi, I., Heugens, P. P. M. A. R. and Boyd, B. K. (2019). 'Information Asymmetry in Management Research: Past Accomplishments and Future Opportunities'. *Journal of Management*, **45**, 122–58.
- Berle, A. A. and Means, G. C. (1932). *The Modern Corporation and Private Property*. New York: MacMillan.
- Berrone, P., Surroca, J. and Tribó, J. A. (2007). 'Corporate Ethical Identity as a Determinant of Firm Performance: A Test of the Mediating Role of Stakeholder Satisfaction'. *Journal of Business Ethics*, **76**, 35–53.
- Bhagat, S. and Tookes, H. (2012). 'Voluntary and Mandatory Skin in the Game: Understanding Outside Director's Stock Holdings'. *The European Journal of Finance*, **18**, 191–207.
- Boivie, S., Bednar, M. K., Aguilera, R. V. and Andrus, J. L. (2016). 'Are Boards Designed to Fail? The Implausibility of Effective Board Monitoring'. *Academy of Management Annals*, **10**, 319–407.
- Brenkert, G. G. (2009). 'Innovation, rule breaking and the ethics of entrepreneurship'. *Journal of Business Venturing*, **24**, 448–64.
- Brownell, K. M., McMullen, J. S. and O'Boyle, E. H. (2021). 'Fatal attraction: A systematic review and research agenda of the dark triad in entrepreneurship'. *Journal of Business Venturing*, **36**.

- Bruneel, J., Gaeremynck, A. and Weemaes, S. (2022). 'Outside board members and strategic orientation of new ventures in the startup phase'. *Strategic Entrepreneurship Journal*, **16**, 801–25.
- Cable, D. M. and Shane, S. (1997). 'A Prisoner's Dilemma Approach to Entrepreneur-Venture Capitalist Relationships'. *Academy of Management Review*, **22**, 142–76.
- Charas, S. and Perelli, S. (2013). 'Threats to Board Stability: Understanding SME Director Behavior'. *International Journal of Disclosure and Governance*, **10**, 175–91.
- Charmaz, K. (2006). *Constructing grounded theory: A practical guide through qualitative analysis*. Los Angeles: Sage.
- Cremers, K. M., Litov, L. P. and Sepe, S. M. (2017). 'Staggered boards and long-term firm value, revisited'. *Journal of Financial Economics*, **126**, 422–44.
- Crosina, E. and Pratt, M. G. (2019). 'Toward a Model of Organizational Mourning: The Case of Former Lehman Brothers Bankers'. *Academy of Management Journal*, **62**, 66–98.
- Dew, N. and Sarasvathy, S. D. (2007). 'Innovations, Stakeholders & Entrepreneurship'. *Journal of Business Ethics*, **74**, 267–83.
- Fama, E. F. (1980). 'Agency Problems and the Theory of the Firm'. *Journal of Political Economy*, **88**, 288–307.
- Finkelstein, S. and Mooney, A. C. (2003). 'Not the usual suspects: How to use board process to make boards better'. *The Academy of Management Executive*, **17**, 101–13.
- Fong, J. (2012, June 5). *Transcript of Proceedings before the Honorable Roland M. Whyte United States District Judge*. United States District Court Northern District of California.
- Forbes, D. P., Korsgaard, M. A. and Sapienza, H. J. (2010). 'Financing decisions as a source of conflict in venture boards'. *Journal of Business Venturing*, **25**, 579–92.
- Fried, J. M. and Ganor, M. (2006). 'Agency Costs of Venture Capitalist Control in Startups'. *New York University Law Review*, **81**, 967–1025.
- Fried, V. H., Bruton, G. D. and Hisrich, R. D. (1998). 'Strategy and the Board of Directors in Venture Capital-Backed Firms'. *Journal of Business Venturing*, **13**, 493–503.
- Frohling, R. G. (n.d.). *Plea Agreement*. Available at Case 2:22-cr-00035-BHL.
- Gamez-Djokic, M., Kouchaki, M. and Waytz, A. (2021). 'Virtuous startups: The credentialing power of the startup label'. *Academy of Management Discoveries*, **8**, 441–58.
- Garg, S. (2013). 'Venture Boards: Distinctive Monitoring and Implications for Firm Performance'. *Academy of Management Review*, **38**, 90–108.
- Garg, S. (2014). 'Microfoundations of Board Monitoring: The Case of Entrepreneurial Firms'. *Academy of Management Review*, **39**, 114–17.
- Garg, S. (2020). 'Venture Governance: A New Horizon for Corporate Governance'. *Academy of Management Perspectives*, **34**, 252–65.
- Garg, S. and Eisenhardt, K. M. (2017). 'Unpacking the CEO–Board Relationship: How Strategy Making Happens in Entrepreneurial Firms'. *Academy of Management Journal*, **60**, 1828–58.
- Garg, S. and Furr, N. (2017). 'Venture Boards: Past Insights, Future Directions, and Transition to Public Firm Boards'. *Strategic Entrepreneurship Journal*, **11**, 326–43.
- Gompers, P. (1996). 'Grandstanding in the Venture Capital Industry'. *Journal of Financial Economics*, **42**, 133–56.

- Gompers, P. and Lerner, J. (2004). *The venture capital cycle*, 2nd ed. Cambridge, Mass.: The MIT Press.
- Greve, H. R., Palmer, D. and Pozner, J.-E. (2010). 'Organizations Gone Wild: The Causes, Processes, and Consequences of Organizational Misconduct'. *Academy of Management Annals*, **4**, 53–107.
- Griffith, E. (2016). 'The Ugly Unethical Underside of Silicon Valley'. *Fortune*, 73–77.
- Hart, O. (1995). 'Corporate Governance: Some Theory and Implications'. *The Economic Journal*, **105**, 678–89.
- Hellmann, T. and Puri, M. (2002). 'Venture Capital and the Professionalization of Start-Up Firms: Empirical Evidence'. *The Journal of Finance*, **57**, 169–97.
- Hillman, A. J., Withers, M. C. and Collins, B. J. (2009). 'Resource Dependence Theory: A Review'. *Journal of Management*, **35**, 1404–27.
- Hsu, D. H. (2008). 'Technology-Based Entrepreneurship', In Shane, S. A. (Ed), *Handbook of Technology and Innovation Management*. Chichester (West Sussex, England): Wiley, 367–88.
- Jensen, M. C. and Meckling, W. H. (1976). 'Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure'. *Journal of Financial Economics*, **3**, 305–60.
- Jones, M. J., Moores, P. B., Currid, K. B. and Healey, M. F. (2018, March 30). *Jury Trial Demanded: Injunctive Relief Sought*.
- Knockaert, M., Bjornali, E. S. and Erikson, T. (2015). 'Joining forces: Top management team and board chair characteristics as antecedents of board service involvement'. *Journal of Business Venturing*, **30**, 420–35.
- Krause, R. and Bruton, G. D. (2014). 'Agency and Monitoring Clarity on Venture Boards of Directors'. *Academy of Management Review*, **39**, 111–14.
- Krause, R., Semadeni, M. and Cannella, A. A. (2014). 'CEO Duality: A review and research agenda'. *Journal of Management*, **40**, 256–86.
- Kravitz, R. and Albright, M. G. (2019, April 8). *Complaint*. Available at Case 3:19-cv-01879-JCS.
- Kuratko, D. F., Holt, H. L. and Neubert, E. (2020). 'Blitzscaling: The good, the Bad, and the Ugly'. *Business Horizons*, **63**, 109–19.
- Lang, N. K. and Wirtz, P. (2022). 'Kicking Off the Corporate Governance Lifecycle: Seed Funding, Venture Capital and the Nascent Board'. *British Journal of Management*, **33**, 181–210.
- Lian, H., Huai, M., Farh, J.-L., Huang, J.-C., Lee, C. and Chao, M. M. (2022). 'Leader Unethical Pro-Organizational Behavior and Employee Unethical Conduct: Social Learning of Moral Disengagement as a Behavioral Principle'. *Journal of Management*, **48**, 350–79.
- Locke, K. D. (2001). *Grounded theory in management research*. Thousand Oaks, CA: Sage.
- Lorsch, J. W. and MacIver, E. (1989). *Pawns or potentates: The reality of America's corporate boards*. Boston: Harvard University Press.
- McElrath, L. H. (2020, January 13). *Upon appeal from the Court of Chancery*. Available at Case No. 181, 2019; C.A. No. 2017-0888.
- McKay, M. C. and Fortunato, M. A. (2020, December 18). *Verified stockholder derivate complaint*. Available at Case document 2:20-cv-02437-DWL.
- McVea, J. F. (2009). 'A field study of entrepreneurial decision-making and moral imagination'. *Journal of Business Venturing*, **24**, 491–504.

- Michael, S. C. and Pearce II, J. A. (2004). 'Choosing Constraints as a Third Solution to Agency'. *Journal of Management Studies*, **41**, 1171–97.
- Miles, M. B. and Huberman, A. M. (1994). *Qualitative data analysis: An expanded sourcebook*, 2nd ed. Thousand Oaks, CA: Sage.
- Milton, T. (2020, November 29). *The Chartcast With TC & Georgia: Episode #53: Trevor Milton*. Available at <https://podcasts.apple.com/mt/podcast/episode-35-trevor-milton/id1491394342?i=1000485476728>.
- Palmer, D. and Weiss, T. (2022). 'The Unique Vulnerabilities of Entrepreneurial Ventures to Misconduct', In Eberhart, R. N., Lounsbury, M. and Aldrich, H. E. (Eds), *Entrepreneurialism and Society: New Theoretical Perspectives*. Bingley, UK: Emerald Publishing.
- Pan, E. J. (2009). 'A Board's Duty to Monitor'. *SSRN Electronic Journal*, **54**, 717–42.
- Pfeffer, J. and Salancik, G. R. (1978). *The External Control of Organizations: A Resource Dependence Perspective*. New York: Harper & Row.
- Pollack, J. M. and Bosse, D. A. (2014). 'When Do Investors Forgive Entrepreneurs for Lying?'. *Journal of Business Venturing*, **29**, 741–54.
- Pratt, M. G., Rockmann, K. W. and Kaufmann, J. B. (2006). 'Constructing Professional Identity: The Role of Work and Identity Learning Cycles in the Customization of Identity among Medical Residents'. *Academy of Management Journal*, **49**, 235–62.
- Ray, J. J. (2022, December 13). *House Financial Services Committee hearing: Investigating the Collapses of FTX, Part I, sked Final*.
- Rutherford, M. W., Buller, P. F. and Stebbins, J. M. (2009). 'Ethical considerations of the legitimacy lie'. *Entrepreneurship Theory and Practice*, **33**, 949–64.
- Sala, G. R. and Pratt, M. G. (2023). 'How Organizations Influence Interpersonal Trust Repair: The Case of a French Antiterrorist Unit'. *Academy of Management Journal*, **66**, 1263–93.
- Schweitzer, M. E., Ordóñez, L. and Douma, B. (2004). 'Goal setting as a motivator of unethical behavior'. *Academy of Management Journal*, **47**, 422–32.
- Shepherd, D. A. (2019). 'Resaerching The Dark Side, Downside, and Destructive Side of Entrepreneurial Action: It's the Compassionate Thing to Do'. *Academy of Management Discoveries*, **5**, 217–20.
- Shepherd, D. A., Seyb, S. and Souitaris, V. (2022). 'On the Edge of Destruction: An Impaired-Regulation Model of Destructive Entrepreneurial Action'. *Journal of Management*, 014920632211267.
- Siggelkow, N. (2007). 'Persuasion with case studies'. *Academy of Management Journal*, **50**, 20–24.
- Sonnenfeld, J. A. (2002). 'What makes great boards great'. *Harvard Business Review*, **80**, 106–13.
- Strauss, A. L. and Corbin, J. M. (1998). *Basics of qualitative research: Techniques and procedures for developing grounded theory*, 2nd ed. Thousand Oaks: SAGE Publications.
- Strebel, P. (2004). 'The Case for Contingent Governance'. *MIT Sloan Management Review*, **45**, 59–66.
- Tacke, F., Knockaert, M., Patzelt, H. and Breugst, N. (2022). 'When Do Greedy Entrepreneurs Exhibit Unethical Pro-Organizational Behavior? The Role of New Venture Team Trust'. *Journal of Management*, **49**, 974–1004.
- The Logan Bartlett Show (2022, June 1). *Parker Conrad tells his side of Zenefits resignation*.

- Theoharakis, V., Voliotis, S. and Pollack, J. M. (2021). 'Going Down the Slippery Slope of Legitimacy Lies in Early-Stage Ventures: The Role of Moral Disengagement'. *Journal of Business Ethics*, **172**, 673–90.
- Überbacher, F. (2014). 'Legitimation of New Ventures: A Review and Research Programme'. *Journal of Management Studies*, **51**, 667–98.
- Umphress, E. E. and Bingham, J. B. (2011). 'When Employees Do Bad Things for Good Reasons: Examining Unethical Pro-Organizational Behaviors'. *Organization Science*, **22**, 621–40.
- Vallaster, C., Kraus, S., Merigó Lindahl, J. M. and Nielsen, A. (2019). 'Ethics and entrepreneurship: A bibliometric study and literature review'. *Journal of Business Research*, **99**, 226–37.
- van den Berghe, L. and Levrau, A. (2002). 'The Role of the Venture Capitalist as Monitor of the Company: a Corporate Governance Perspective'. *Corporate Governance: An International Review*, **10**, 113–252.
- Vullo, M. T. (2017). *New York State Department of Financial Services: In the Matter of YourPeople, Inc., d/b/a Zenefits FTW Insurance Services Respondent*.
- Waldron, T. L., McMullen, J. S., Petrenko, O. V., Trudell, L. T., & Aronson, O. (2022). Entrepreneur-investor rivalry over new venture control: The battle for Balcones Distilling. *Journal of Business Venturing*, **37**(4), 106225.
- Weir, C. and Laing, D. (2003). 'Ownership Structure, Board Composition, and the Market for Corporate control in the UK. An Empirical Analysis'. *Applied Economics*, **35**, 1747–59.
- Yao, T. and O'Neill, H. (2022). 'Venture capital exit pressure and venture exit: A board perspective'. *Strategic Management Journal*, **43**, 2829–48.
- Yin, R. K. (2014). *Case study research and applications: Design and methods*, 6th ed. Thousand Oaks, CA: Sage.
- Yu, M.-C., Wang, G. G., Zheng, X.-T. and Shi, W.-J. (2020). 'Entrepreneur Narcissism and Unethical Pro-Organizational Behaviour: An Examination of Mediated-Moderation Model'. *Economic Research-Ekonomska Istraživanja*, **33**, 501–20.
- Zahra, S. A., Filatotchev, I. and Wright, M. (2009). 'How do threshold firms sustain corporate entrepreneurship? The role of boards and absorptive capacity'. *Journal of Business Venturing*, **24**, 248–60.
- Zahra, S. A. and Pearce, J. A. (1989). 'Boards of Directors and Corporate Financial Performance: A Review and Integrative Model'. *Journal of Management*, **15**, 291–334.
- Zhang, J. J., Baden-Fuller, C., & Pool, J. K. (2011). Resolving the tensions between monitoring, resourcing and strategizing: Structures and processes in high technology venture boards. *Long Range Planning*, **44**(2), 95-117.
- Zhang, J., Soh, P. and Wong, P. (2010). 'Entrepreneurial Resource Acquisition through Indirect Ties: Compensatory Effects of Prior Knowledge'. *Journal of Management*, **36**, 511–36.

Figure 1

Data structure

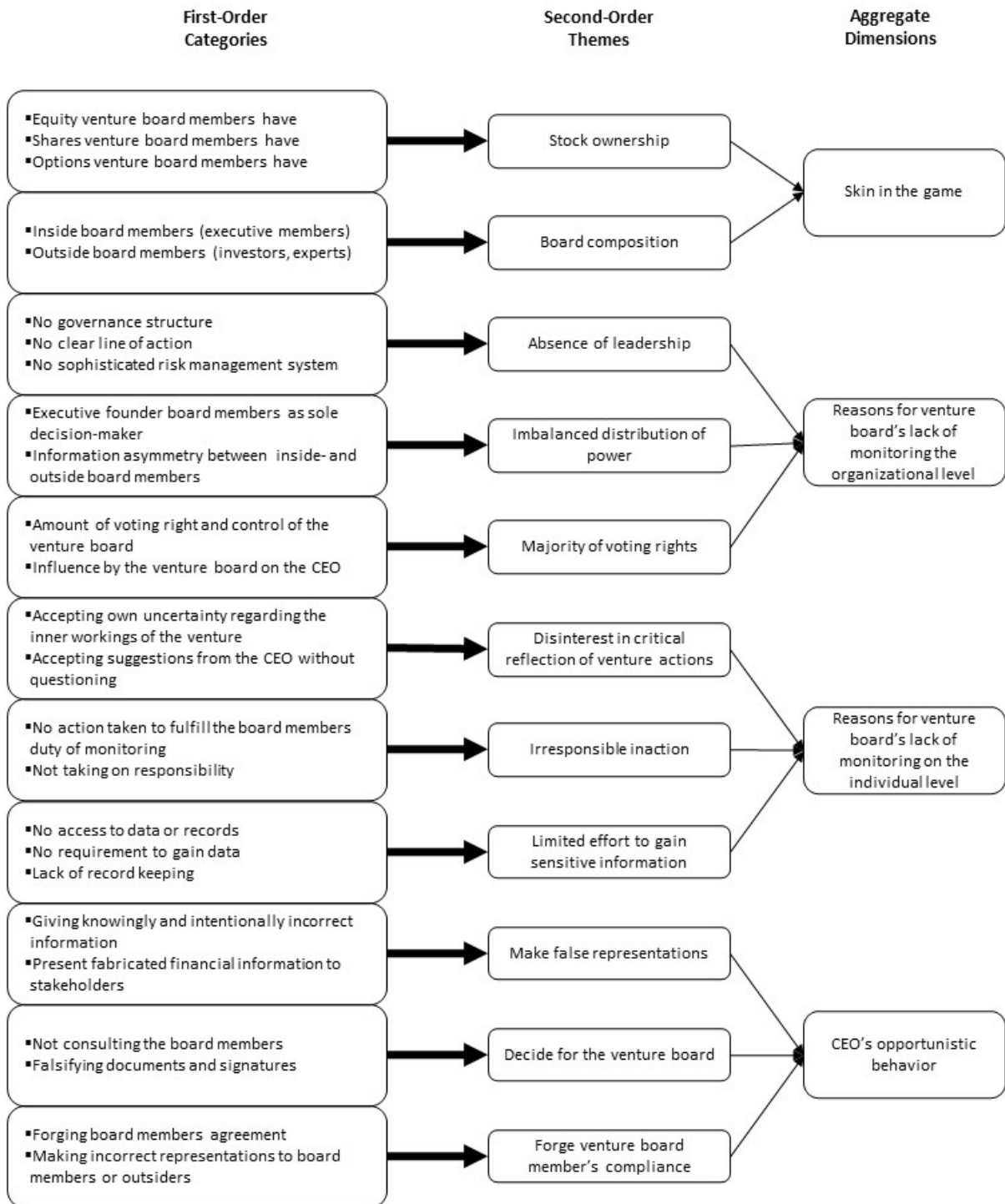


Figure 1: Data Structure

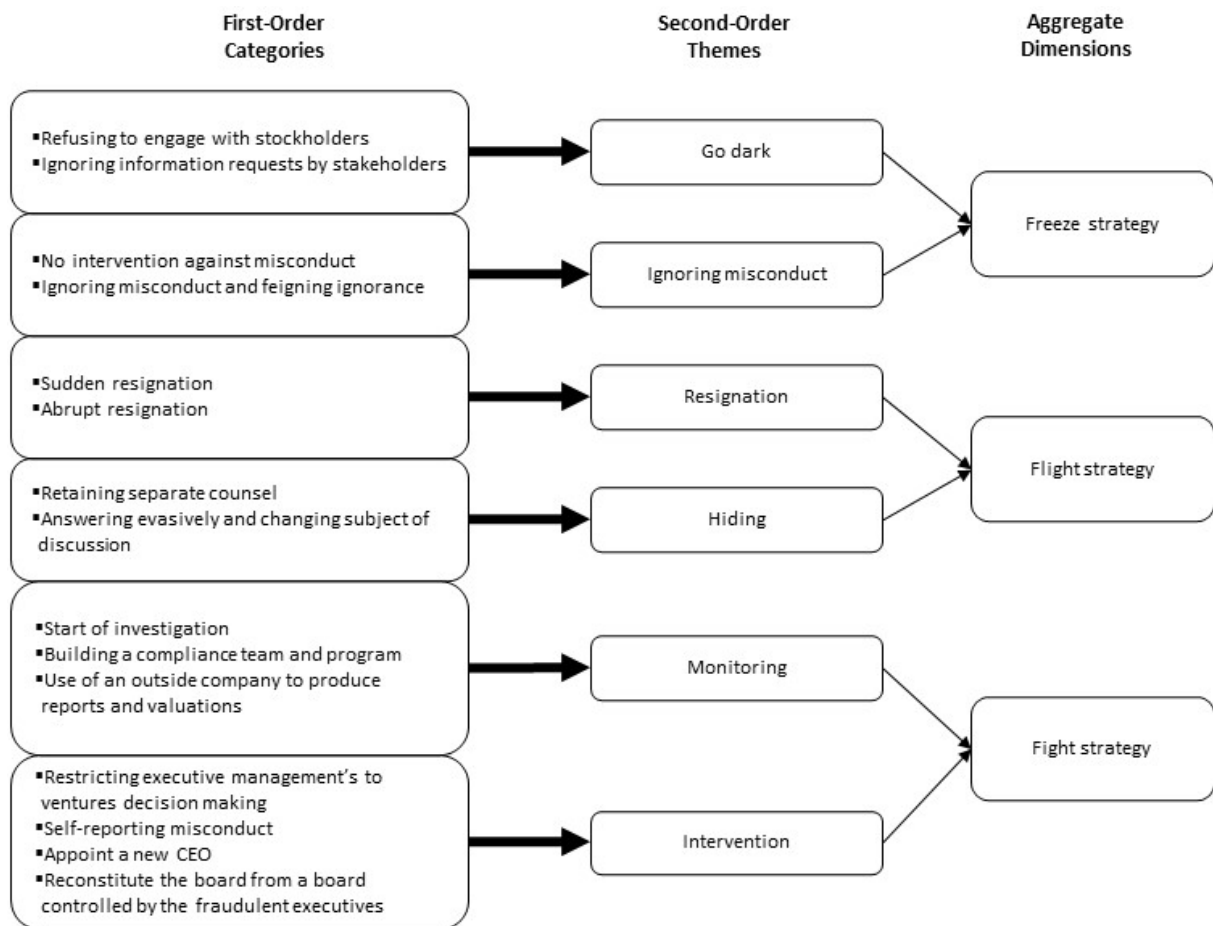


Figure 2

A process model of venture board's monitoring absence in venture fraud cases

