ANGEL INVESTORS IN INITIAL PUBLIC OFFERINGS (INTERACTIVE PAPER)

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INTERACTIVE PAPER

ANGEL INVESTORS IN INITIAL PUBLIC OFFERINGS

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Principal Topic

Before conducting an initial public offering (IPO), the equity of a private firm is typically held by a combination of investors including venture capitalists, managers of the firm, and angels. There has been little research conducted looking at the influence of angels on the initial public offering of a firm, despite the importance of angel investors. This paper fills this void in the literature, examining the role of angel investors in the process of bringing firms into the public market. We examine the determinants of angel versus venture backing for IPO firms. In addition, we examine the incentives of venture capitalists to underprice offerings more heavily relative to angel investors, allowing venture capitalists to raise more funds in the future (grandstanding).

Method

The initial sample of IPOs is obtained from the Security Data Corporation new issues database from 2001 to 2005. We use the IPO firm prospectus to obtain information about the stock holders of the IPO firm at the time of the offering. To classify angel investors we eliminate all firm employees and all investors classified as venture capitalists by Pratt's Guide. Individuals who get through these screens are classified as angel investors. This results in a final dataset of 445 IPO firms with a total of 329 angel investors.

Results and Implications

We find that 22% of all IPO firms going public from 2001-2005 have angel investors in the firm, indicating that these investors provide vital capital to firms going through initial public offerings. Venture capitalists invest in high cash burn-rate, low leverage industries located largely in California, Massachusetts, and Texas. Angels invest in low cash burn-rate, high leverage industries with a more uniform distribution across the country. Our results imply that angel investors help to fill a funding gap taking on investments that venture capitalists either cannot or will not take, particularly in markets where few venture capitalists are located. We also find that higher underpricing (grandstanding) is present in venture backed firms as opposed to those firms with only angel capital. To our knowledge, this is the first paper studying firm financing from angels that uses archival data rather than self-reported data from angels.

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