VENTURE CAPITALISTS’ INFLUENCES ON START-UP SUCCESS VERSUS FAILURE (SUMMARY)

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SUMMARY

VENTURE CAPITALISTS’ INFLUENCES ON START-UP SUCCESS VERSUS FAILURE

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Principal Topic

Do venture capitalists (VCs) influence whether their portfolio companies succeed or fail? How do they exert this influence? Researchers have examined how VC involvement affects IPO underpricing, perceptions of success, access to networks, management and governance expertise, and professionalization of marketing and distribution efforts (e.g., Kaplan and Stromberg, 2002; Gompers 1995; Lerner 1995, Sapienza, 1992; Baum and Silverman, 2004). Yet we know surprisingly little about how VCs systematically influence the ultimate outcomes of start-up firms.

Method

The relevant literature presents conflicting evidence. On the one hand, there is a relatively large literature on VC activities and how they influence portfolio companies and add value (e.g. Kaplan and Stromberg, 2002; Gompers 1995; Lerner 1995, Sapienza, 1992; Baum and Silverman, 2004). Within this literature also persists the question of whether VCs add value through coaching and bringing resources to the venture versus they simply select high potential start-ups (Baum and Silverman, 2004; Bradner et al., 2002). On the other hand, a recent study that quantifies the contribution of VCs shows the “VC effect” to be relatively modest – around 11% (Fitza, Matusik, and Mosakowski, 2007) – based on examining changes in valuations of portfolio companies between funding rounds.

Results and Implications

In this study we address how VCs differ in their influence on the post-VC-investment fates of start-up firms. How much does a particular VC’s involvement affect whether its portfolio companies are successfully sold (on the IPO market or with a private acquisition) versus declare bankruptcy? We present a theoretical model drawing from the corporate effects literature to develop our arguments on how ownership by superordinate entities – here VCs – affects firm actions and outcomes. To address these questions, we employ a novel form of variance decomposition analysis that is based on ordinal regressions.

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