VENTURE CAPITAL INVESTMENT AS CAPITAL MARKET SIGNAL IN NEW VENTURES AT IPO: A COMPARATIVE INVESTIGATION OF VENTURE CAPITALIST AND INVESTMENT BANK REPUTATION EFFECTS (SUMMARY)

Markus Fitza
Leeds School of Business, University of Colorado at Boulder, USA, markus.fitza@colorado.edu

Thomas J. Dean
Colorado State University, College of Business, Fort Collins, USA

Recommendation Citation
Fitza, Markus and Dean, Thomas J. (2009) "VENTURE CAPITAL INVESTMENT AS CAPITAL MARKET SIGNAL IN NEW VENTURES AT IPO: A COMPARATIVE INVESTIGATION OF VENTURE CAPITALIST AND INVESTMENT BANK REPUTATION EFFECTS (SUMMARY)," Frontiers of Entrepreneurship Research: Vol. 29: Iss. 3, Article 5.
Available at: http://digitalknowledge.babson.edu/fer/vol29/iss3/5

This Summary is brought to you for free and open access by the Entrepreneurship at Babson at Digital Knowledge at Babson. It has been accepted for inclusion in Frontiers of Entrepreneurship Research by an authorized administrator of Digital Knowledge at Babson. For more information, please contact digitalknowledge@babson.edu.
SUMMARY

VENTURE CAPITAL INVESTMENT AS CAPITAL MARKET SIGNAL IN NEW VENTURES AT IPO: A COMPARATIVE INVESTIGATION OF VENTURE CAPITALIST AND INVESTMENT BANK REPUTATION EFFECTS

Markus Fitza, Leeds School of Business, University of Colorado-Boulder, USA
Thomas J. Dean, Colorado State University, College of Business, Fort Collins, USA

Principal Topic

This study quantifies and compares the relative importance of underwriters and VCs for underpricing in initial public offerings (IPOs). A critical aspect of IPO underpricing is the information asymmetry between current owners and potential investors. Existing theory argues that such information asymmetry can be reduced by signaling the value of a venture through means that are considered valid in the perception of IPO investors (e.g., Stuart, Hoang, and Hybels, 1999).

While signals based on the certification of IPOs by investment banks have received substantial attention and empirical analysis, research on the role of venture capitalists (VCs) in this process is only beginning to emerge. Furthermore, there is little research that compares the relative influence of investment banks in alleviating underpricing, to that of VCs.

Method

Based on a sample of 1,840 IPOs, which represent 19 years, 51 industries (at 2 digit SIC codes), 86 underwriters and 557 venture capital firms, we measure the proportions of the underpricing of venture backed IPOs that can be attributed to the VC, underwriter, industry and the year of the IPO by applying a variance decomposition analysis.

Results and Implications

With 23.64% the VC effect accounts for the largest portion of the variance in IPO underpricing, while the underwriter effect accounts for only 12.14%. The year effect accounts for 4.35% of the variance in IPO underpricing, and the industry effect accounts for 2.14%.

The results indicate that VCs are of larger importance in signaling quality than underwriters. This opens interesting new research avenues. Although underwriters are often seen as certifiers of quality, they themselves have only a limited ability to judge a start-up. VCs on the other hand can - through their long term involvement with the start-up - directly influence quality. The findings suggest that underwriter reputation is discounted by the market because of exiting information asymmetries between the VC and their star-ups and the underwriter.

CONTACT: Markus Fitza; markus.fitza@colorado.edu; (T): 720-381-8993; University of Colorado UCB 419, Boulder, Colorado 80309, USA.