DO VCs MATTER? (SUMMARY)

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SUMMARY

DO VCs MATTER?

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Principal Topic

In this study we determine the effect of venture capital (VC) affiliations on the value of new ventures. Previous studies in strategic management investigated the effects of corporate ownership on the performance of business units, the so-called “corporate effect.” Most such studies indicate that business unit effects, as well as, industry effects, are the main determinants of profitability, and that the benefit of being associated with a corporation is negligible.

The relationship between a startup firm’s valuation and its “membership” within the portfolio of a VC is analogous to a business-unit’s performance and its membership within a corporate portfolio. Contrary to the literature about corporate effects, previous studies show that VCs do influence the performance of their portfolio companies. This research however, does not address what proportion of the increase in the value of a new venture is attributable to these activities. Is the VC effect significantly larger than the corporate effect? And how does it compare to industry and business (venture) level effects for startup firms?

The purpose of this study is to determine the magnitude of the VC effect on the value of startups. In doing so we will reconcile the fundamental differences between the strategic management findings on corporate effects with the entrepreneurship literature on how VCs interact with their portfolio companies.

Method

We are using a variance decomposition approach previously used to identify corporate effects (Schmalensee, 1985; Rumelt, 1991). Our sample is based on data from the Venture Expert database (SDC Platinum by Thomson Financial) as well as form SEC filings. The dependent variable is the increase in the total firm valuation of the startup between two rounds of funding minus the capital invested in the most recent funding round.

Results and Implications

We believe this paper will make two important contributions. First, it adds to the existing literature of corporate effects. The VC case illustrates under which conditions a membership effect can be substantial. Second, establishing the magnitude of the VC effect offers a first step toward understanding the importance of VC strategies.

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