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CORPORATE VENTURE CAPITAL AND ACQUISITIONS OF ENTREPRENEURIAL FIRMS (INTERACTIVE PAPER)

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≈ INTERACTIVE PAPER ≈

**CORPORATE VENTURE CAPITAL AND ACQUISITIONS
OF ENTREPRENEURIAL FIRMS**

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Principal Topic

The management literature has suggested that corporate venture capital (CVC) creates firm value, particularly when technological firms target entrepreneurial ventures (Dushnitski & Lenox, 2005). Particularly, corporations can use CVC investments to build options to acquire entrepreneurial companies if their technologies are proven strategically valuable. However, the finance literature has found that CVC-backed acquisitions in general generate negative returns due to agency problems (Benson & Ziedonis, 2005). Thus, it deserves further investigation on how to mitigate agency problems in such transactions so that corporate investors could fully utilize strategic benefits associated with CVC investments.

In this study, we examine several factors which may enhance the performance of CVC-backed acquisitions. In general, we believe corporate investors may use CVC investments to obtain toehold positions prior to subsequent additional equity investments for an ultimate takeover. Such toehold positions and sequential investment strategies will help overcome asymmetric information. In addition, corporate investors may pay attention to the timing of acquisitions, the location proximity, and business relatedness of portfolio companies. These factors would help corporate investors monitor business operation of portfolio companies and also contribute toward reduce information asymmetry.

Method

Consistent with the literature, a toehold position is defined as less than five percent of outstanding stock, the threshold for not filing with the Security and Exchange Commission. Our primary information for subsequent investments and takeovers is from VentureXpert database for the period 1980 through 2006. The listing status of portfolio company at the time of acquisition as well as its location is also obtained from VentureXpert. The business relatedness is calculated based on the 4-digit SIC codes of both the corporate investor and its portfolio company. Firm accounting data is from the Compustat database, while stock returns are from the Center for Research in Security Prices (CRSP). To measure the wealth effect of the toehold acquisition, we examine stock-price reaction to the acquisition announcements using the event-study methodology.

Results and Implications

Our study examines the impacts of several factors on the performance of CVC-backed acquisitions. The findings of this research can help maximize value for the entrepreneurial firms as well as the CVC investors. By considering both public and private targets as well as degree of initial investment in the targets, we can refine the knowledge of both entrepreneurial firms and CVC investors, and improve their decision-making as potential targets and acquirers. The study may also suggest that CVC investors choose their acquiring targets based on geographic proximity and business relatedness.

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