UNDERSTANDING THE DYNAMICS OF VENTURE CAPITAL INVESTMENTS THROUGH MACROECONOMIC DOWNTURNS (SUMMARY)

Jeffrey S. Petty
University of Lausanne, Switzerland, jeffrey.petty@unil.ch

Elisabeth Beck Reynolds
MIT, USA

Andreas Gyllenlid
Codified Ltd., UK

Recommended Citation
Petty, Jeffrey S.; Reynolds, Elisabeth Beck; and Gyllenlid, Andreas (2017) "UNDERSTANDING THE DYNAMICS OF VENTURE CAPITAL INVESTMENTS THROUGH MACROECONOMIC DOWNTURNS (SUMMARY)," Frontiers of Entrepreneurship Research, Vol. 37 : Iss. 1 , Article 10.
Available at: https://digitalknowledge.babson.edu/fer/vol37/iss1/10

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 editor of Digital Knowledge at Babson. For more information, please contact digitalknowledge@babson.edu.
SUMMARY

UNDERSTANDING THE DYNAMICS OF VENTURE CAPITAL INVESTMENTS THROUGH MACROECONOMIC DOWNTURNS

Jeffrey S. Petty, University of Lausanne, Switzerland
Elisabeth Beck Reynolds, MIT, USA
Andreas Gyllenlid, Codified Ltd., UK

Principal Topic

Venture capitalists (VCs) are generally not long term investors and prefer investments where a profitable exit can be expected to happen in the shortest time following an investment (Cummings, 2010). However, although VCs may try to time their divestments to maximize the value of any project, Gompers (1996) suggests that they also try to time their divestments in order to maximize the probability that they will receive money for the next fund. Thus, diversification of risk involves spreading investments across business opportunities which have fundamentally different bases for success. Some VCs may be pursuing risk hedging strategies to correct for business cycle shocks yet there is a lack research focused on how contextual factors impact investment strategies (Zacharakis and Meyer, 2000). As such, our inquiry focuses on the functioning of market forces with respect to stimulating VC investment into longer-term industries and examines whether VCs shift their investment preferences toward deals with longer average times to exit in response to economic recessions.

Method

Data on VC investments from 1980-2013, which includes more than 70,000 deals and sorted by 69 classifications, is obtained from Thomson Financial’s VentureXpert database. Two dependent measures are employed: (i) the share of the total number of VC deals, and (ii) the total investment amounts in the respective industries. Independent variables include information on the U.S. business cycle, which is collected from the NBER’s Business Cycle Dating Committee. In order to control for market fluctuations, measures of the NASDAQ, IPO trends (Ritter, 1985, 2014) and the real interest rate are included as controls.

Results and Implications

Based on VC investment choices through each of the economic downturns since 1980, our results provide evidence indicating that VCs do shift their investment preferences toward longer time to exit industries during economic downturns. More specifically, the share of VC investments and number of deals flowing to longer term to exit industries increase in economic trough years and the years immediately following the trough, while decreasing on average across the entire time period. Hence, entrepreneurs operating in industries that have slower clock speeds should be made aware that the characteristics of their industry may make them relatively more attractive to VCs during economic troughs. Nevertheless, research is required to determine if this response to macroeconomic change is actually hedging risk or simply a correction of conditions that otherwise artificially keep VCs focused on shorter term to exit industries.

CONTACT: Jeffrey S. Petty; jeffrey.petty@unil.ch; (T) 41-21-692-3354; (F) 41-21-692-3305; HEC, University of Lausanne, 1015, Lausanne, Switzerland.