DO VENTURE CAPITALISTS WEIGH THEIR INVESTMENT CRITERIA DIFFERENTLY AT THE PRE-INVESTMENT AND POST-INVESTMENT STAGES? (SUMMARY)

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Recommended Citation  
Available at: http://digitalknowledge.babson.edu/fer/vol27/iss3/11

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SUMMARY

DO VENTURE CAPITALISTS WEIGH THEIR INVESTMENT CRITERIA DIFFERENTLY AT THE PRE-INVESTMENT AND POST-INVESTMENT STAGES?

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Principal Topic

Extant research has been divided as to whether VCs are likely to offer a venture additional financing after they had provided it with the initial round(s) of investment. Some scholars have argued that VCs prefer not to continue investing in a portfolio company for diversification reasons (Dean & Guglierano, 1990). Conversely, proponents of escalation of commitment have claimed that VCs become too emotionally attached and organizationally bound to their portfolio companies; hence, VCs fail to discontinue funding of even clearly failing ventures in a timely fashion (Ryan, 1998, Guler, 2003, Birmingham et al., 2003). In contrast to both approaches, we argue that VCs exhibit a continuation bias because of their belief in a substantial reduction of uncertainty at the post-investment stage due to greater availability of information and their own involvement in venture governance.

Method

We have conducted a series of interviews and surveys of 51 VCs operating in different parts of the U.S. VCs were asked to weigh some positive information regarding a number of investment criteria: initially, assuming that they evaluate a venture at the pre-investment stage, and subsequently, assuming that they evaluate it at the post-investment stage. We have theorized that VCs will exhibit a greater willingness to reinvest than to initially invest based on analogous positive information concerning two most important groups of investment criteria related respectively to venture and its competitive environment.

Results and Implications

The results partially support our hypotheses. Based on analogous positive information related to venture and its competitive environment, VCs reported that they will be more likely to reinvest than to initially invest in a company. This finding has important implications concerning the effectiveness of VC decision making. If VCs are more likely to reinvest than to initially invest in a venture, they may disproportionally allocate resources to previously funded companies, and overlook more attractive investment opportunities.

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