THE IMPACT OF NEW VENTURE DESIGN ON ENTREPRENEURIAL EXIT

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In this research we examine how the selection and assembly of initial strategic resources (financial, human, and technological) impact the entrepreneurial exit strategy. Our results suggest that an IPO exit strategy is positively related to all three types of strategic resources, while a strategic sale exit strategy is positively related to financial resources or total initial investment, and a sale to an individual exit strategy is positively associated with percentage of ownership, a financial resource. Implications for research and practice are discussed.

INTRODUCTION

Entrepreneurship research has recently begun to recognize and focus upon entrepreneurial exit as an important component of the entrepreneurial process (e.g. Leroy, Manigart, & Meulman, 2007; McGrath, 2006; Wennberg & Wiklund, 2006). The distinction of this emerging research is that entrepreneurial exit is viewed as a central part of the new venture value creation effort (DeTienne, 2008). This research follows a call by entrepreneurship scholars to focus upon the entrepreneur as a designer of the organization and to seek to understand his or her point of view (Sarasvathy, 2004). While some research has examined the human capital of the entrepreneur as determinants of the exit path (e.g. Leroy et. al., 2007; Wennberg, Wiklund, DeTienne, & Cardon, 2008), in this study we examine how the assembly of initial financial and non-financial strategic resources impact an entrepreneur’s exit strategy. We look at two specific questions: 1) why do some entrepreneurs, and not others, develop an exit strategy? And 2) what resource decisions influence the specific exit strategy considered?

Two theoretical perspectives inform this research. First, previous research in entrepreneurship indicates that the selection and assembly of initial resources (Brush, Edelman, & Manolova, 2008; Greene & Brown, 1997) may be one of the most important tasks of founding teams (Ardichvili, Cordozo, Tune, & Reinach, 2002). This perspective goes beyond traditional resource based (RBV) research (which primarily explores the link between resources and competitive advantage) to examine the impact of selection and assembly of resources on firm outcomes.

Second, organizational imprinting (Boeker, 1989; Doz, 1996; Marquis, 2003; Stinchcombe, 1965) indicates that the accumulation of strategic resources and business model design may leave a lasting imprint upon the firm. “The conditions under which an organization is born and the course of its development in infancy have nontrivial consequences for its later life” (Kimberly, 1979: 438).

Because entrepreneurial exit is seen as an important component of the entrepreneurial process, the primary question in this research focuses upon the impact of initial strategic resources on different types of exit strategies. Specifically we examine the impact of initial strategic resources (financial, human, and technological) on the development of an exit strategy and on the specific exit strategy considered (sale to an individual, strategic sale, and IPO).
THEORETICAL FOUNDATION

Strategic Resources, Resource Assembly, and Organizational Imprinting

Strategic resources are those resources developed by management as the basis for their firm’s competitive advantage (Amit & Schoemaker, 1993). A significant amount of research in the strategy literature has examined the link between strategic resources and competitive advantage (see Newbert, 2007 for a summary); however, little research has taken a step back to examine the selection and assembly of those resources. As early as 1965 Ansoff proposed that a major problem of business is the configuration of these critical resources. Of particular importance to the start-up entrepreneur are fundamental strategic choices about both financial and non-financial strategic resources (Ardichvili, et al., 2002; Bhide, 2000; Brush, Edelman, & Manolova, 2008; Brush, Greene, & Hart, 2001; Moliterno & Wiersema, 2007). Resource assembly and selection are among the first actions undertaken by entrepreneurs to begin building a resource base (Brush et al., 2008).

Which resources are important for the start-up entrepreneur and thus relevant to the current research? Previous research has identified at least six categories of strategic resources: financial, physical, human, technological, reputation, and organizational resources (Grant, 1991). Ansoff (1965) categorized resources as physical, monetary, and human. Similarly, Van de Ven (1993) noted three categories of resources that are critical to all the development of almost all technology and industries: technological, financial, and human. In a recent meta-analysis Song, Podoyntysna, van der Bij, & Halman, (2008) verified that these three sets of resources contribute to positive firm outcomes. Thus, it would follow that these three sets of resources are appropriate to examine entrepreneurial exit.

The selection and assembly of these initial resources may have impact far beyond the initial decisions. “Organizations set on a course at founding from which change may be costly or difficult, suggesting that early patterns of organizing may limit the range of future strategic actions that firms are likely to consider” (Boeker, 1989: 492). Researchers refer to the impact of founding conditions on future outcomes as organizational imprinting (Boeker, 1989; Doz, 1996; Kimberly, 1979; Koch, 2008; Marquis, 2003). Various theoretical perspectives including switching costs (Williamson, 1985), path dependency (Koch, 2008), structural rigidity (Hannan & Freeman, 1984), routines (Nelson & Winter, 182), sunk costs (Arkes & Blumer, 1985), and core rigidities (Leonard-Barton, 1992) may be invoked to explain organizational imprinting. Each of these perspectives provide insight into why decisions made early in the life of the firm impact future decision making. It is important to note that organizational imprinting is not synonymous with organizational inertia. Doz (1996) shows how this initial imprinting can promote either highly adaptive firms or highly inert firms depending upon how they are set.

Some of the organizational imprinting research has focused upon the initial resource assembly such as the founder (Kimberly, 1979; Schein, 1983), human and financial capital (Cooper, Gimeno-Gascon, & Woo, 1994) and networks (Marquis, 2003) while others have examined early strategic decisions such as strategy (Boeker, 1989) and location (Brush, et al., 2008). The organizational outcomes examined include, among others, first sale (Brush, et al., 2008), new venture performance (Cooper, et al., 1994), organizational change (Boeker, 1989; Tucker, Singh, Meinhard, 1990), organizational mortality (Romanelli, 1989; Swaminathan, 1996), growth (Cooper, Gimeno-Gascon & Woo, 1991), and strategic alliance outcomes (Doz, 1996). However, because of the relatively recent shift in focus to entrepreneurial exit as an important outcome, no research that we are aware of has examined the impact of the firm’s initial strategic resources on

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entrepreneurial exit.

**Resource Assembly and Entrepreneurial Exit**

While other scholars have examined firm outcomes noted above, DeTienne (2008) makes the argument that entrepreneurial exit is a critical outcome of the entrepreneurial process and has a significant effect not only on entrepreneurs, but also on firms, industries, and the economy. She argues that the exit has both financial and psychological implications for the founder, is a key milestone in the life of the firm (Rubenson and Gupta, 1996) which may have both positive (e.g. infusion of cash from IPO) and negative implications (e.g. a disruptive event), affects the industry through the change in competitive balance (Akhigbe, Madura & Martin, 2003), and affects the general economy (e.g. through entrepreneurial recycling and redistribution of wealth).

It is also important to note that an entrepreneur’s exit strategy may vary across many different exit paths ranging from an initial public offering (IPO), which is often considered a very successful mode of exit, to typically unsuccessful modes of dissolution of the firm or outright bankruptcy (See Birley & Westhead, 1993; Petty, 1997 for reviews). We focus on three specific types of exit strategies, including IPO, strategic sale, and sale to an individual (non-family member).

An exit via IPO is a risky, intense, and complex strategy, but one that offers a high financial return to the entrepreneurs (e.g. Babich and Sobel, 2004). In a recent IPO that garnered significant public attention, Google founders Sergey Brin and Larry Page, who each owned approximately 15% of the company’s stock, became instant millionaires when they raised $1.67B for Google’s IPO. However, an IPO is a risky strategy that often requires a significant financial outlay without any guarantee of success (Demers & Joos, 2007).

An exit via a strategic sale (sale to another firm) is also a desirable exit strategy because often acquisition premiums are paid to the exiting entrepreneur, making it a highly lucrative exit strategy for entrepreneurs (Haunschild, 1994). However, acquisitions are also known to be problematic for the acquiring firm, due to their complexity, high human and financial costs, and the resources that need to be devoted to adequate personal and technological communication and integration (Pepper & Larson, 2006). Strategic buyers tend to look for firms that are a strategic fit (cost saving advantages and/or operational synergies) with the existing firm. Firms may also be acquired by private equity firms. Private-equity buyouts—one of the fastest growing exit routes (Berman, 2007; O’Sullivan, 2006)—are acquisitions by a managed pool of funds comprised of qualified investors. From the first half of 2005 to the first half of 2006 U.S. private equity transactions grew 19% (Bernard and Kaplan, 2006).

An exit via a sale to another individual primarily occurs in the low-end market and may include the use of a business broker. In this type of exit, the financial payout is often lower than with the first two types of exit. Not including inventory or real estate, the average price of a business that sells utilizing a business broker is about $250K (Zahorsky, 2005). However, the entrepreneur may be able to exercise greater control over who buys the firm and may remain in an advisory capacity to the new owner after the exit.

Despite the fact that entrepreneurial exit is an important topic, early research indicates that fewer than 50 percent of entrepreneurs have an exit strategy (Dahl, 2005; Holmberg, 1991). If all entrepreneurs will eventually exit (Perry, 1997), why do some entrepreneurs, and not others, develop an exit strategy? One difference may have to do with the goals or motivations at the time.
of founding (Stewart, Carland, Carland, Watson, & Sweo, 2003; Morris, Miyasaki, Watters, & Coombes, 2006; Wiklund, Davidsson, & Delmar, 2003). In their seminal work differentiating entrepreneurs from small business owners, Carland, Hoy, Boulton, & Carland (1984) develop a conceptual framework which suggests that small business owners establish and manage a business to further personal goals and the business will be the founder’s primary source of income and constitute the majority of his or her time and resources. Others (Barringer & Ireland, 2008) have referred to the small business founder as a lifestyle or income-replacement entrepreneur.

Conversely, Carland, et. al. (1984) suggest that the entrepreneur establishes and manages a business primarily for profit and growth. They suggest that the entrepreneur is “characterized principally by innovative behavior and will employ strategic management practices in the business” (Carland, et al., 1984: 358). In an empirical test of Carland et al.’s conceptual framework Stewart, et al. (2003) found that entrepreneurs differed from small business owners in need for achievement, risk-taking propensity, and preference for innovation. Thus entrepreneurial ventures characterized by more total investment, more founders, high levels of innovation, and low percentage of ownership are more likely to have an exit strategy in place. Thus,

\[ H1a: \text{Founders who develop entrepreneurial ventures characterized by (a) more founders, (b) higher levels of innovation, (c) larger total initial investment, and (d) lower percentage of ownership are more likely than lifestyle founders to consider an exit strategy.} \]

Additional research suggests that these expectations or motivations may impact initial resource decisions (e.g. Brush, et al., 2008). Entrepreneurs with high growth expectations or motivations will seek a broader scope and variety of resources at start-up than lifestyle entrepreneurs (Brush, et al, 2001; Vesper, 1990). In their research examining home-based versus away-based ventures, Brush, et al. (2008) determined that home-based business assemble different types of resources and that higher aspirations were associated with a greater accumulation of resources. In general then we would expect that high-growth entrepreneurs seeking high impact exits (e.g. IPO, strategic sale) would assemble more founders, higher levels of innovation and greater financial resources. In contrast, “…lifestyle entrepreneurs may be content to manage and control their ventures not requiring significant scale and scope of resources” (Brush, et al., 2008: 163.)

In addition and more specifically, the previous research indicates that teams of founders are significantly more likely to create growth ventures than are individual entrepreneurs (Brush, et al., 2001). The evidence seems to indicate that while individual entrepreneurs create lifestyle ventures, teams provide the important network contacts and complementary skill sets necessary for successful growth ventures (Brush, et al., 2001). The logic follows then that size of the founding team will be positively related to an IPO or strategic sale exit strategy.

Similarly, the level of innovation of the firm’s initial product/s can be examined using the scale of resources argument. Products with high levels of innovation broaden the scope of the resource base and it is expected that entrepreneurs with a highly innovative product are more likely to seek a high impact exit. The venture capital literature supports this supposition as the bulk of this literature suggests that highly innovative product-based firms are more likely to reach an IPO. In addition, the amount of financial investment in the firm is related to the entrepreneur’s motivations and expectations. Founders with a higher initial investment are more likely to seek a high impact exit. Again, this is supported by the venture capital literature.

Finally, the percentage of ownership in the firm may impact the type of exit strategy. Single founders and those with a strong psychological attachment (Pierce, et al., 2001) are more likely to
select an exit where they can remain involved in the firm rather than a focus on financial outcomes. This is more likely to occur in exit involving sale to an individual than with exit by IPO or strategic sale, because in the former type of exit entrepreneurs have greater control over who the firm is sold to and often maintain an advisory role, at least during the ownership transition. In their research on small business owners, Wiklund, et al. (2003) found that for some entrepreneurs, noneconomic concerns may be more important than financial outcomes in determining overall attitude toward growth. Thus we hypothesize the following:

\[ H2: \text{Size of founding team will be positively related to (a) IPO, (b) strategic sale, and negatively related to (c) sale to an individual.} \]

\[ H3: \text{Level of innovation will be positively related to (a) IPO, (b) strategic sale, and negatively related to (c) sale to an individual.} \]

\[ H4: \text{Total initial investment will be positively related to (a) IPO, (b) strategic sale, and negatively related to (c) sale to an individual.} \]

\[ H5: \text{Percentage of ownership will be negatively related to (a) IPO, (b) strategic sale, and positively related to (c) sale to an individual.} \]

**METHODOLOGY AND RESEARCH DESIGN**

The data used in this study is part of a larger data set. The sampling frame for this study comes from the 2002 Dun & Bradstreet directory, which primarily contains information on privately held companies. We used the Total Design Method (TDM) described by Dillman (2000) to survey firm founders in two industries (electrical measurements and surgical/medical instruments). One-hundred-eighty-nine individuals responded with usable surveys for a response rate of 17.8 percent. Of the 189 respondents, 167 indicated that they were the founder or members of the founding team and were used in this analysis.

**Measures**

Two measures were used as control variables: age of the firm and size of the firm. Because age and size of the firm have been shown to impact results in entrepreneurship and may impact an entrepreneur’s exit strategy, we included these variables in the analysis. Founders were asked to indicate the age of the firm (start date). The size of the firm (total number of full time employees) was measured using Dun & Bradstreet secondary data.

The size of founding team was determined by asking the respondents to respond to the following question: “How many individuals made up the founding team?” This was an open-ended question ranging from 1 to 8 with a mean of 2.3. To measure the level of innovation, we used a scale developed by Fiet (2002) and modified by Chandler and DeTienne (2004). Respondents were asked “Which of the following best describes your initial product/service?” Possible responses were: (1) A replication of existing products/services used in similar applications, (2) A new application for an existing product/service with little or no modification, (3) A minor modification to an existing product/service, (4) A significant improvement to an existing product, (5) A combination of two or more existing products into one unique product/service, and (6) A product/service that is new to the world. Results ranged from 1 to 6 with a mean of 3.48.
To measure percentage of ownership respondents were asked “What is your percentage of ownership in the company?” Response categories included: No ownership (3%); more than zero but less than five percent (5%), greater than five percent but less than 25 percent (11%), greater than 25 percent but less than 50 percent (22%), greater than 50 percent but less than 75 percent (20%), and more than 75 percent (40%). To measure total initial investment we asked respondents “What was the total initial investment?” Response categories included “less than $10K (20%), more than $10K but less than $25K (13%), more than $25K but less than $50K (11%), more than $50K but less than $100K (11%), more than $100K but less than $500K (24%), more than $500K but less than $1M (9%), and more than $1M (12%).

Our dependent variables consist of three different exit strategies. Founders were asked to indicate on a five point Likert scale (anchored by highly unlikely/highly likely) the likelihood of each of the different exit strategies (sale to an individual, IPO, strategic sale) as described in the literature. Because both the dependent variables and some of the independent variables consist of categorical data we collapsed categories of the dependent variables into a binary coding scheme. Although collapsing categories can result in loss of information (Murad, Fleischman, Sadetzki, Geyer, & Freedman, 2003), it is a fairly common procedure to collapse categories with low cell counts to improve asymptotic approximations used for hypothesis testing (Altman, 1991; Tansey, White, Long, & Smith, 1996).

Our research uses responses from a single respondent in each company. When both the predictor and the dependent variables come from the same source there exists the potential for common method bias (Podskoff & Organ, 1986). We took several procedural steps to minimize any measurement bias due to common methods. First, we were careful in our research design as our approach of one informant per organization has been supported when survey instruments were well designed and executed (Starbuck & Mezias, 1996). For example, we pre-tested the instrument, the items of interest were interspersed throughout the survey, and several items were reverse coded.

Second, we examined only those responses from the founders of the firm (Chandler & Lyon, 2001). In new firms the founder is frequently the only person with the requisite knowledge. Third, social desirability may also be an issue with common method. Because we asked respondents if they had considered an exit strategy, they may have responded affirmatively simply because it appeared socially desirable to do so. We feel this is somewhat attenuated as approximately one third of our sample responded that they did not have an exit strategy and because respondents were assured of confidentiality. In addition, because this study is part of a larger data base, the respondents would have been unable to determine the link between the independent and dependent variables; thereby minimizing social desirability. Finally, we used archival data from the Dun & Bradstreet data base as our control items.

To examine for non-response bias we compared responses to the first (n=128) and the second mailing (n=61). Analysis of variance indicate no significant differences between the demographic variables, and more importantly between the variables of interest in our study: age of the firm, size of the firm, size of founding team, level of innovation, total initial investment, percentage of ownership, considered an exit strategy, IPO, strategic sale, or sale to an individual.

RESULTS

We used both ANOVA and binary logistic regression to analyze the data. Table 1 shows the descriptive statistics and correlations among all study variables. Table 2 shows the results of the
ANOVA and Table 3 the results of the regression analysis.

In Hypothesis 1 we hypothesized that founders who develop ventures characterized by more founders, higher levels of innovation, larger total initial investment, and lower percentage of ownership are more likely to consider an exit strategy. Our results indicate support for higher levels of innovation, larger total initial investment, and lower percentage of ownership providing support for H1b, H1c, and H1d.

We hypothesized (H2) that the size of founding team would be positively related to both an IPO exit strategy and a strategic sale but negatively related to a sale to an individual exit strategy. Our results support the positive relationship between size of founding team and IPO providing support for H2a. The other relationships were not supported. We hypothesized (H3) that the level of innovation would be positively related to both an IPO and strategic sale exit strategies, but negatively related to a sale to an individual exit strategy. Our results support the positive relationship between level of innovation and IPO providing support for H3a. The other relationships were not supported.

We hypothesized (H4) that the total initial investment would be positively related to both an IPO and strategic sale exit strategies, but negatively related to a sale to an individual exit strategy. Our results support the positive relationship between total initial investment and IPO and between total initial investment and strategic sale providing support for H4a and H4b. The other relationship was not supported. Finally, we hypothesized (H5) that the percentage of ownership would be negatively related to both an IPO and strategic sale exit strategies, but positively related to a sale to an individual exit strategy. Our results support the positive relationship between percentage of ownership and individual exit strategy providing support for H5c. The other relationships were not supported.

DISCUSSION AND IMPLICATIONS

In the new venture creation process the entrepreneur can be described as the designer of the firm (Sarasvathy, 2004) as they make decisions about how to use and allocate strategic resources. Sarasvathy (2004: 714) says that as entrepreneurship scholars, we should “try to understand how entrepreneurs fashion particular strategies in particular industries or create firms with particular exit strategies….“ In this vein, we explore how three types of strategic resources, human resources (size of founding team), technological resources (level of innovation), and financial resources (total initial investment and percentage of ownership), might influence an entrepreneur’s specific exit strategy. We know that not all entrepreneurs are motivated purely by financial rewards, and reasons for exit may involve personal and non-financial motives as well as financial ones (Petty, 1997), so it is important to consider how different resources influence the exit decision.

In this research, we contend that decisions regarding strategic resources have an important impact on the exit strategy, or way in which the entrepreneur captures the value that has been created. In particular, we suggested that there might be marked differences in the exit strategy for entrepreneurs based on three types of resource investments. Our results support such a view. In particular, we found that human resources are associated with a greater tendency to exit by IPO. The size of the founding team is directly related to an IPO exit strategy. We suggest this may be due to larger teams having more of a growth orientation with their firms, which is associated with high return exits, such as IPO. Technological resources are also associated with exit by IPO Firms that have more innovative products may have a broader resource base and a greater chance of
growth and ultimately a lucrative exit by IPO for the entrepreneur(s). In contrast, the relationship between financial resources and exit strategy depends on the specific resource. Where total initial investment is higher, entrepreneurs tend towards exit strategies of IPO or strategic sale. This may be due to their primary motive of becoming an entrepreneur being a financial one, thus they are more inclined to seek to exit in ways that maximize their financial return. Percentage of ownership appears to be associated with exit by sale to another individual. This may be due to the notion of psychological ownership (Pierce et al., 2001), where individuals feel personally attached to their ventures and thus seek to maintain some relationship with the company even after the exit. Having a higher percentage of the total ownership in the business may be associated with a higher level of such psychological ownership. This would most likely occur for small business owners or lifestyle entrepreneurs than for profit-maximizing growth entrepreneurs.

Looking at this study from an exit strategy perspective indicates that sale to an individual is associated with financial resources in terms of percentage of ownership an individual has in the firm, and not with human or technology resources. Strategic sale is associated with total initial investment in the firm, and not human or technological resources. Finally, exit by IPO is associated with all three types of strategic resources: human, technological, and financial.

These results have a number of implications for the literatures on strategic resources and organizational imprinting, as well as on entrepreneurial exit. First, our study suggests that the initial strategic resource choices that entrepreneurs make have an impact on the exit strategy that entrepreneurs intend to use. Because of this, entrepreneurs are likely to make choices about how to develop and grow their ventures to ensure they can utilize their preferred exit strategy. For example, the relationship between the size of founding team and the exit strategy of an IPO suggests that firms founded by a larger number of individuals will pursue high growth strategies, including rapid product development, geographic expansion, or acquisition of smaller firms, in order to increase their chances of staging a successful IPO. Thus, the initial strategic resource assembly starts the firm toward a course of action that is specific to that configuration of resources.

Second, our study suggests that one way to understand the exit strategies entrepreneurs pursue is by looking at early strategic decisions they make, including the initial assembly of resources. At times scholars have confounded exit with failure of firms, which is a mistake in our eyes. While both involve departure of the entrepreneur from the firm, there are fundamental differences. Failure of firms involves reactive closure of the venture due to poor performance, while exit involves proactive and planned departure of the entrepreneur from the venture, which may be ongoing and successful regardless of the exit. Because the mode of exit is a proactive strategic decision entrepreneurs make, it is important to study what factors influence that decision. In this paper, we look at the initial configuration of resources at firm founding as one set of factors that influences the exit strategy chosen. Our findings suggest that this initial configuration impacts whether or not entrepreneurs have an exit strategy, as well as what particular exit strategy they intend to pursue.

For both entrepreneurs and instructors of entrepreneurship this research indicates the importance of considering how best to allocate and use new venture resources. It also suggests the need to educate students of entrepreneurship concerning what exit modes are possible, and how strategic decisions make even prior to firm founding can have a profound impact on the way the venture carries forward and how the entrepreneur can harvest the value of the venture.
REFERENCES


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<th>Firm Size</th>
<th># Founders</th>
<th>Innovation</th>
<th>Total Invstmt</th>
<th>% Ownership</th>
<th>IPO</th>
<th>Strategic Sale</th>
<th>Sale Individual</th>
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Table 2: Results from the Anova

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*0=No exit strategy; 1=exit strategy

* p<.05

** p<.01

Table 3: Regression Analyses

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<td>Model 1</td>
<td>Model 2</td>
</tr>
<tr>
<td>Constant</td>
<td>1.07</td>
<td>7.42**</td>
</tr>
<tr>
<td>Firm Size</td>
<td>3.94*</td>
<td>.37</td>
</tr>
<tr>
<td>Firm Age</td>
<td>2.49</td>
<td>.02</td>
</tr>
<tr>
<td>Size of founding team</td>
<td>5.91*</td>
<td>1.41</td>
</tr>
<tr>
<td>Level of Innovation</td>
<td>6.22*</td>
<td>.17</td>
</tr>
<tr>
<td>Total Initial Investment</td>
<td>6.54*</td>
<td>4.42*</td>
</tr>
<tr>
<td>Percentage of Ownership</td>
<td>.00</td>
<td>.00</td>
</tr>
</tbody>
</table>

Pseudo\(^1\) R\(^2\) | .09 | .42 | .02 | .13 | .06 | .21 |

Pseudo Adj R\(^2\) | .33 | .11 | .15 |

\(^1\)Nagelkerke

* p<.05

** p<.01