WHAT HAPPENS TO NEW FIRMS THAT TRY, BUT FAIL TO RAISE VENTURE CAPITAL? A UNIVERSITY SPINOUT PERSPECTIVE (SUMMARY)

Harveen Chugh  
*University of London, UK, harveen.chugh@ymail.com*

Nicos Nicolaou  
*University of Cyprus, Cyprus*

Yiannis Gabriel  
*University of London, UK*

Simon Barnes  
*Tate & Lyle Ventures, UK*

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SUMMARY

WHAT HAPPENS TO NEW FIRMS THAT TRY, BUT FAIL TO RAISE VENTURE CAPITAL? A UNIVERSITY SPINOUT PERSPECTIVE

Harveen Chugh, University of London, UK
Nicos Nicolaou, University of Cyprus, Cyprus
Yiannis Gabriel, University of London, UK
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Principal Topic

This study builds theory on how the failure to raise venture capital affects the development of new firms. Our context is a unique type of new firms, university spinouts, which are formed to commercialize intellectual property developed within universities (Shane, 2004). Although university spinouts have provided a strong source of deal flow for venture capitalists (Franklin et al., 2007), most spinouts find it difficult to raise such funding (Binks et al., 2004).

Method

We used a theory building (Pentland, 1999), process (Pettigrew, 1997) and multiple case study approach (Yin, 2003). The sample consisted of six biotechnology spinouts from Imperial College London. Data collection took place over three years and utilized multiple sources of evidence (Yin, 2003). Data analysis and theory building involved coding; within-case analysis; cross-case analysis; and constructing theoretical propositions. The data was linked to two theoretical perspectives that explain the findings: escalation of commitment, which explains how organizations behave following a negative outcome from a course of action (Staw, 1976; Staw, 1981), and organizational learning (Argyris & Schön, 1978, 1996), defined as a process of detecting and correcting error, which allows the organization to continue with (single-loop learning), or modify its goals or objectives (double-loop learning).

Results and Implications

We present a typology of VC feedback into (i) inconsistent, (ii) consistent and workable and (iii) consistent and unworkable feedback. We find that when start-ups fail to raise venture capital, inconsistent VC feedback leads to a greater escalation of commitment to raising finance than consistent and workable VC feedback. We show that single-loop learning mediates the relationship between VC feedback and escalation of commitment. We also find that consistent and unworkable VC feedback increases the likelihood of an exit and that inhibited double-loop learning mediates the relationship between VC feedback and exit.

This study contributes to studies on failure in the entrepreneurship literature (Shane, 2008; McGrath, 1999), performance feedback models in organizational learning (e.g. Branzet et al., 2004; Lant & Hurley, 1999; Mezias et al., 2002), and research on VC feedback (Sapienza & Korsgaard, 1996; Shepherd & Zacharakis, 2002).

CONTACT: Harveen Chugh; harveen.chugh@rhul.ac.uk; (T):00-44-1784-276287; Royal Holloway University of London, Egham, Surrey, TW20 0EX, UK.