ON THE VALUE OF THE AGENCY RELATIONSHIP BETWEEN PRESTIGIOUS VCS, UNDERWRITERS AND SHAREHOLDERS (SUMMARY)

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SUMMARY

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Principal Topic

VCs and underwriters play an important, but underexplored, role in IPOs. Ownership, length of board service, and number of VCs invested in the pre-IPO firm is negatively related to underpricing and VC involvement is “recognized by capital markets through lower underpricing for IPOs with better monitors” (Barry et al, 1990: 447).

Previous research raises a number of questions regarding the pre/post-IPO roles of VCs and investment bankers. The present study tests multiple agency perspectives to understand how different types of VCs and underwriters can undermine process outcomes. By examining the performance of firms accused of material mis-statement of operational facts and/or performance expectations, we discern differences between VCs and underwriters on the control issues of interest. This legal action sample is prima facie evidence of breakdown in monitoring and certification.

Method

We examine a sample of 246 IPOs (111 VC-backed, 135 non-VC-backed) sued by shareholders for material mis-statements in the issuing prospectus and other related charges. We extracted the sample from Thomson Financial’s SDC New Issues database which includes all firm-commitment new issues 1980-2002. Segment and accounting data (sales, assets) are retrieved from Compustat. We control for firm age (logged years), firm size (logged assets, sales prior to IPO), overhanging shares, initial filing width, firm age pre-IPO, institutional ownership, and high-technology industry. Preliminary results indicate that VC-backed IPOs exhibited larger underpricing than non-VC backed IPOs. Regressions show that highly desirable VC-backed firms are charged with more SEC offences, have more charges dismissed, and have smaller settlements.

Results/Implications

The incentive to match prestigious underwriters with a reputation for severe underpricing with prestigious venture-backed firms is substantial. Both VCs and underwriters gain: VCs certify the issuing firm and thereby attract a prestigious lead underwriter; underwriters receive benefits in underpricing the stock (as they are compensated by both issuer and investors). Both VCs and underwriters benefit in the agency relationship, especially as VCs switch to a shorter-term perspective during the IPO stage as they execute exit strategies and demonstrate strong returns for their investors. Moreover, as they continually seek to bring new/emerging ventures to market, maintaining a relationship with prestigious underwriters is crucial to their success.

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