CVC FROM THE START-UP PERSPECTIVE: A QUALITY OR MIXED SIGNAL? (SUMMARY)

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SUMMARY

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Principal Topic

Corporate venture capital (CVC) funding represents a significant part of the venture capital market (Chesbrough, 2002). CVC investments give the investing firm a window onto new technological developments, and CVCs benefit the most from these investments when they are strategic in nature, rather than purely financial (e.g., Dushnitsky & Lenox, 2006) and when the CVC has a high level of involvement with the start-up companies it invests in (Wadhu & Kotha, 2006). Interestingly, we know relatively little about the effect of these investments on the financial performance of the start-ups receiving them. For example, if the CVC firm benefits the most from having strategic motives associated with the start-ups it invests in, what does this mean to the start-up firm?

Theoretical Foundation

In this paper, we examine what effect CVC funding has on the receiving start-up company’s financial performance, specifically in the IPO market. To do so, we draw on Rock’s (1986) theory of information asymmetry to explain underpricing.

To assess the true value of a start-up that has CVC funding, an investor must understand the nature of the relationship between the start-up and its CVC investors. For example, will the start-up company have to give preferential treatment or access to its CVC investors? CVC investment in a start-up company means there is more information needed that is specific to each CVC investment in order to assess the value of the start-up company. Thus, the IPO will be underpriced to compensate for these information asymmetries. Accordingly, we hypothesize that CVC investments will be positively associated with underpricing.

Methods, Results, Implications

To test our hypotheses we combine data from multiple sources over the period of 1990-2006, yielding a sample of 1387 firms. Controlling for start-up firm age, size, underwriter quality and market conditions at the time of IPO, we find that CVC funding does significantly contribute to underpricing, consistent with theory that more information is necessary to understand the nature of this relationship. CVC funding, however, decreases underpricing when the CVC is the lead investor.

Through this study, we provide a window onto what the start-up company gains from CVC involvement, complementing the growing literature on what CVCs gain from these relationships.

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