VC FUNDING, TIME HORIZONS AND TECHNOLOGY DEVELOPMENT: IMPLICATIONS FOR START-UPS' LONG-RUN PERFORMANCE (SUMMARY)

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Principal Topic

It is well established that VCs can positively impact the start-up companies in which they invest. They not only provide financial resources, but also help their portfolio companies formulate strategy, professionalize the firm, and transfer reputational assets, network resources, and other intangible assets. They also control and discipline management. VCs also invest in conjunction with a specific time line in mind. Can the significant influence a VC has over the strategy and management of the start-up it invests in coupled with this finite time horizon move the start-up firm to develop along a trajectory that undermines its long-term profitability?

In this study, we examine how the underlying sources of a start-up’s potential long-term competitive advantage—in the form of the technology characteristics of the start-up—interact with how it is funded, to affect its performance over time (i.e., one, three and five year post-IPO performance). More specifically, we examine the relationship between VC funding and post-IPO performance, and how technology characteristics moderate this relationship, hypothesizing that VC funding hampers long run performance in the case of start-ups with broad technology portfolios and basic science orientations, while it helps in the context of start-ups with narrow technology portfolios and more applied technologies.

Method

We combine data from a number of sources for this study. We used the SDC New Issues database to identify firms conducting initial public offerings. Stock return data was obtained from the CRSP tapes. Patent data were obtained from the USTPO to assess technology characteristics of the start-ups, and accounting data were obtained from COMPUSTAT. Preliminary analyses on data collected on 793 firms for the first 18 years of our sample provide support for the hypothesized relationships.

Results and Implications

This study makes a theoretical contribution to research on how outsider ownership affects innovation decisions by empirically separating time horizon issues from those issues related to the classic separation of ownership and control which doesn’t exist in the start-up context. Our results also suggest that the time line associated with developing a start-up’s source of competitive advantage should be considered in conjunction with financing choices.

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