SCIENCE-BASED LEGITIMACY: THE VALUE RELEVANCE OF INTERACTING SIGNALS FOR YOUNG FIRMS (SUMMARY)

Michele Meoli  
*University of Bergamo, michele.meoli@unibg.it*

Silvio Vismara  
*University of Bergamo*

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SUMMARY

SCIENCE-BASED LEGITIMACY:
THE VALUE RELEVANCE OF INTERACTING SIGNALS FOR YOUNG FIRMS

Michele Meoli, University of Bergamo, Italy
Silvio Vismara, University of Bergamo, Italy

Principal Topic

The information gap between the founders of a high-tech start-up and external investors is likely to be extraordinarily large. As a consequence, these firms face significant challenges gaining the attention of potential investors and, to some extent, the matter is conveying the right signals to potential financiers the quality of the firm. Such signaling challenge reaches its peak with the decision to go public, that assures financial means, but involves the convincement of the investment community that the firm has a long-term potential. Scholars have identified a variety of internal and external signals of firm quality as a means to reduce uncertainties when valuing these new issues. In particular, researchers have documented the role of third-party endorsements as certification mechanisms. In this paper, we investigate the effect on the valuation of IPOs of three kinds of affiliation, namely prestigious underwriters, venture capitalists, and university.

Method

We analyze the biotech firms that went public in Europe in the period from 1995 to 2008. The list of IPO firms is from the EURIPPO database that provides prospectuses and other detailed information on all companies that have recently gone public in Europe. Based on these data, our sample is made of 254 biotech companies that went public in Europe in the period 1990-2008.

Results and Implications

Our results provide evidence that multiple prestigious affiliates operate in an additive and/or substitutive manner in affecting investors’ valuations. Taken singularly, the signal provided by the affiliation with a top-tier underwriter, venture capitalist, or university enhance the valuation of the firm. Taking into considerations the interactions of signal, we find that signal provided by venture capitalists shades, as it is moderated by its overlapping with the endorsements by reputable underwriters and universities. We argue that underwriters provide the strongest certification role due to positive selection, while universities bring the strongest certification of substantive business benefits. Venture capitalists mix these two roles.

CONTACT: Michele Meoli; michele.meoli@unibg.it; (T): +390352052352; (F): +390352052077; Department of Economics and Technology Management, University of Bergamo, viale G. Marconi, 5, 24044, Dalmine (BG), Italy.