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VENTURE CAPITALISTS’ INDIVIDUAL-OPPORTUNITY NEXUS AND INVESTMENT PERFORMANCE (SUMMARY)

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Principal Topic

In this study, we drew on human capital theory and entrepreneurship theory to develop a framework for investigating the unique and joint effects of venture capitalists’ (VC) human capital and business opportunity characteristics on investment performance. In our study, we examine three types of human capital endowments a VC accumulates from past experience: operational knowledge, entrepreneurial knowledge, and financial knowledge. We consider VC as the entrepreneur in their unique context and propose that these endowments provide a unique ability for a VC to exploit an entrepreneurial opportunity (i.e., an investment opportunity).

Method

We start with a sample of 835 U.S. VCs in the information technology industry who had at least one IPO between 1995 & 2002. We collected VCs’ biographical information by doing searches with VCs’ first and last names using websites and data sources (e.g., Zoominfo and LinkedIn). We used the Thomson Financial/Thomson Econometrics VentureXpert database to collect investment transaction data between 1990 and 2005 on the following variables: the average stage at which a VC entered a deal across all portfolio companies invested; the average number of portfolio companies a VC managed per year, and percentages of all the investments a VC made that went IPO.

Results and Implications

After taking into consideration individual and firm level effects, we found that knowledge about how to operate a company (C-level executive experience) and about how to start a company (entrepreneurial experience) are both relevant for a VC’s investment performance. However, their benefits are constrained by the stage at which a VC invests and how many portfolio companies a VC manages on average per year. For VCs investing mostly in the early stages, the benefit of having executive experience peaked around year 10 (inverted U-shape curvilinear effect on IPO performance); while for VCs who invested largely at later stages, C-level executive experience had a linear, positive effect on IPO performance. Although managing more companies annually lowers IPO performance for everyone, VCs with above-average entrepreneurial experience (average among all those with such experience) performed better than those without such experience or those with below-average entrepreneurial experience when they manage fewer portfolio companies per year (about .75).

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