CONTINGENT ROUND FINANCING IN VENTURE CAPITAL (INTERACTIVE PAPER)

Will Drover
Southern Illinois University, will.drover@gmail.com

William McKinley
Southern Illinois University

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VENTURE CAPITAL

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Will Drover, Southern Illinois University, USA
William McKinley, Southern Illinois University, USA

Principal Topic

Venture capital (VC) investment has emerged as an important component of entrepreneurship. As such, researchers have provided important insights on a range of factors associated with VC investment decisions (Petty and Gruber, 2011). A hallmark of this literature is that VC investment is viewed largely from the perspective of initial investment. While the initial investment decision is a critical hurdle that many entrepreneurs must overcome, it marks the beginning rather than the end of a lengthy process. Specifically, it is well-documented that VCs generally allocate capital in a series of contingent rounds (Sahlman, 1990), where the decision to reinvest is continually revisited. Thus, we have a growing understanding of why VCs “get in the game”, but we know little about the influences that determine follow-on investments.

To address this gap, we conceptually and empirically investigate VC reinvestment decisions. Our model acknowledges that financial and market performance metrics play a central role in reinvestment decisions. However, given the conditions of heightened uncertainty, these decisions are not as straightforward as one might expect because there are number of contextual and social factors brought to bear and in some cases these considerations trump performance outcomes (Guler, 2007). Thus, this research seeks to enhance our understanding of the social, non-economic factors influencing funding decisions in subsequent investment rounds.

Method

We use a two stage triangulated research design. First, we conduct semi-structured qualitative interviews with practicing VCs to identify espoused social variables that appear to influence reinvestment decision policies. These variables form the basis of a conjoint analysis experiment. Here, the conjoint portion of our study provides insights into which variables are most influential in reinvestment decisions, as well as how such variables interact with one another to determine the likelihood of reinvestment.

Results and Implications

By modeling and empirically investigating the influences of VC reinvestment decisions, we make a number of contributions. Broadly, we advance our understanding of the reasons why VCs choose to exercise their option to follow-on, or to disengage from future rounds of financing. We demonstrate that it is a nexus of interacting social and economic variables that comprise such decisions. Collectively, it is our hope that these findings encourage further research into this important facet of the VC cycle.

CONTACT: Will Drover; will.drover@gmail.com; (T):805.570.5950. SIU. Carbondale IL, 62901.