INVESTMENT AND RETURNS IN SUCCESSFUL ENTREPRENEURIAL SELL-OUTS (SUMMARY)

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SUMMARY

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Principal Topic
The assumption of capital constraints on entrepreneurs frames much entrepreneurship research with the general expectation that in a new venture more cash is better. But owing to limited availability of data on the terminal liquidity value of new ventures, empirical examinations of the ultimate merits of this assumption are scarce.

Method
We assembled a unique hand-gathered dataset comprising the entire universe of 3,160 private firms acquired by U.S. publicly-traded entities during the years 1996-2006. Combining data from SEC 8K Filings, Thomson & Reuter’s Done Deals database, 50 different state incorporation databases, the US Census Longitudinal Business Database, the PriceWaterhouseCoopers Moneytree and NVCA database, and the US Government Environment, Health and Safety database, we analyze financial outcomes of:

- Revenues and assets in order to assess venture growth
- Years to liquidity
- Transaction price
- Total cash out
- Total profit generated in the transaction

Results and Implications
We find that increases in equity significantly accelerate venture growth and increase firm valuation at acquisition. We further exploit variation in the total amount of equity invested in ventures in our data to show that equity displays a pattern of significant diminishing marginal returns to growth, exit speed, terminal venture value, total cash extracted from the venture and profit to the entrepreneur. Following these main effect analyses, we split the sample into two groups representing two alternative financing strategies. Termed Earners and Burners, members of the former group fund growth with money from sales revenue, while the latter group funds growth with equity capital. We find that Burners grew and exited faster, but their overall use of capital significantly reduced their rate of return.

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