



ELSEVIER

Contents lists available at SciVerse ScienceDirect

J. Finan. Intermediation

journal homepage: www.elsevier.com/locate/jfi



Relational venture capital financing of serial founders



Ola Bengtsson

Lund University School of Economics and Management, Sweden

ARTICLE INFO

Article history:

Received 1 July 2009

Available online 12 April 2013

Keywords:

Venture capital

Entrepreneurship

Relational lending

ABSTRACT

I study how often and why a serial founder receives financing for his new company from a venture capital (VC) firm that also invested in his previous company. One in 10 VC investments leads to a repeated relationship and one in three serial founders enters into a repeated relationship with any previous VC firm. A repeated relationship is more likely when the relational VC firm has acquired more private information about the founder, but less likely if the founder's new venture has a bad fit with the VC firm's geographic or industry focus. My findings add to the literature on relational financing by showing that the preservation of information is an important motivation for relational financing when screening and monitoring costs are high. Yet, repeated relationships are discontinued because investors also respond to information problems by specializing in certain types of firms. Finally, I find evidence of non-relational investments being passed onto trusted VC syndication partners.

© 2013 Elsevier Inc. All rights reserved.

1. Introduction

Relationships are believed to be advantageous in overcoming information problems in finance (Black, 1975; Diamond, 1984; Fama, 1985). Although relational financing has received considerable attention in the literature, most of the evidence for this comes from lending situations involving banks. Research shows that banks frequently practice relational lending and that strong bank relationships make credit more readily available to corporate borrowers.¹

E-mail address: ola.bengtsson@nek.lu.se

¹ Notable papers include James (1987), Lummer and McConnell (1989), Petersen and Rajan (1994), Berger and Udell (1995), Cole (1998), Ongena and Smith (2001), Drucker and Puri (2005), Bharath et al. (2007), Hellmann et al. (2008), Gopalan et al. (2011) Bharath et al. (2011), and Ivashina and Kovner (2011).

This paper investigates financing relationships in a previously unexplored setting, the venture capital (VC) industry, now an important part of the US economy. I study serial founders, who form a key subgroup among individuals who found companies financed by VC firms. As reported by Gompers et al. (2010), about 10% of all founders have previously started another venture-backed company, and such serial founders enjoy significantly higher success rates than first-time founders do. I study repeated VC relationships in which serial founders receive financing for new companies from VC firms that also invested in one of the same founder's previous companies. My research investigates the roles of private information and investor specialization in the formation of such repeated VC relationships.

Repeated VC relationships are interesting to study from a theoretical perspective because this setting is rife with information problems between entrepreneur and investor, which can be overcome by relational financing arrangements. A VC firm that has financed a serial founder's previous company has likely acquired significant private information about the founder through prior due diligence, monitoring, and active involvement (Gorman and Sahlman, 1989; Kaplan and Strömberg, 2004; Lerner, 1995; Hellmann and Puri, 2002). Private information about a serial founder may be valuable given the importance of human capital in the early stages of venture-backed company lifecycles (Kaplan et al., 2009; Gompers et al., 2010) and the high monitoring and adverse selection costs that characterize investing in such companies. Thus, if information preservation were the primary motivation for relational financing then relationships would be commonplace in the VC setting.

This line of reasoning is, however, incomplete because high information costs often lead investors to specialize in certain types of entrepreneurs and to narrow their investment focus. Studies have shown that VC firms frequently specialize along industry and geographical dimensions (Gupta and Sapienza, 1992; Norton and Tenenbaum, 1993; Sorensen and Stuart, 2001; Hochberg et al., 2010, and Gompers et al., 2009). A serial founder may therefore achieve the most efficient matching arrangement not with a relational VC but instead with a non-relational VC whose due diligence and monitoring skills more closely match the characteristics of his new company. If the impact of investor specialization were more valuable than preserving private information through relational financing, then repeated financing relationships would not be commonplace in situations, such as the VC setting, in which information costs are high.

In this paper, I investigate the prevalence of repeated VC relationships by analyzing a hand-collected sample that comprises 3540 VC involvements for 637 serial founders of US venture-backed companies. I demonstrate that one out of 10 VC involvements leads to a repeated relationship and one in three serial founders has a repeated relationship with a previous VC investor. This fraction is about five times higher than would be predicted by randomly matching VCs and serial founders.

The finding that relationships between serial founders and particular VCs are sometimes discontinued could, when analyzed in isolation, mean that VC financing is often not motivated by the preservation of information. According to this explanation, repeated relationships have little value because private information about a founder plays no central role when a VC firm evaluates a business plan. Yet, by exploring cross-sectional differences in the prevalence of relational financing, I show that this explanation is incorrect. Preserving information about a founder is an important motivation for relational VC financing but is counteracted by the need for a good match between specialized VC firms and a founder's new company. Thus, my results indicate that relationships sometimes discontinue because the information acquired by most VC firms is not valuable *enough* to outweigh the cost of a suboptimal match and other potential costs associated with relational financing.

A univariate comparison of the most extreme cases in my sample illustrates the empirical relevance of the tradeoff between preserving information about a serial founder and obtaining a good match between a company and a VC firm. The probability that repeated relationships occur is 67% for VC firms that have had both the strongest and most recent involvement with a founder (and thereby the best opportunities to acquire private information) and the best possible industry and geography match with the founder's new company. The corresponding probability is 0% for VC firms that have had the weakest involvement and the worst possible industry and geography match.² Hence, my re-

² See Table 4 for an exact definition of how these two groups are formed.

متن کامل مقاله

دریافت فوری ←

ISIArticles

مرجع مقالات تخصصی ایران

- ✓ امکان دانلود نسخه تمام متن مقالات انگلیسی
- ✓ امکان دانلود نسخه ترجمه شده مقالات
- ✓ پذیرش سفارش ترجمه تخصصی
- ✓ امکان جستجو در آرشیو جامعی از صدها موضوع و هزاران مقاله
- ✓ امکان دانلود رایگان ۲ صفحه اول هر مقاله
- ✓ امکان پرداخت اینترنتی با کلیه کارت های عضو شتاب
- ✓ دانلود فوری مقاله پس از پرداخت آنلاین
- ✓ پشتیبانی کامل خرید با بهره مندی از سیستم هوشمند رهگیری سفارشات