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Venture capital, financial leverage and enterprise performance

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Abstract

This paper aims to study the relationship among venture capital (VC), financial leverage and enterprise performance by empirical study, utilizing the data from China's GEM (Growth Enterprises Market) listed companies of 2010-2014. The empirical results show that: VC is positively related to enterprise performance, and financial leverage is negatively correlated with corporate performance; Moreover, further research indicates that this negative relationship becomes larger and more significant in the VC-backed firms by introducing the cross term of VC and financial leverage.

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Keywords: Financial leverage, Venture capital, Enterprise performance, GEM;

1. Introduction

Enterprise's financing and its influence on the enterprise performance, which determine the survival and development of the enterprise, have always been a hot topic of research. Venture capital (hereafter VC) and debt financing are important external financing modes for innovative enterprises, and they are of great significance for enterprises to obtain the funds needed for the production and operation. VC is a new type of financing. It plays a more and more important role in small and medium-sized enterprises, especially in technological innovative ones. VC can provide financial and management support for the enterprise, so as to promote the growth of its performance [1]. However, as a part of the VC institutions are keen on the Pre-IPO projects, the impact of VC on the enterprise performance is uncertain [2]. The financing way can affect the enterprise performance by influencing the proportion of financial leverage. There are more and more literature to research the relationship between financial leverage and firm performance, but the conclusions are quite different [3], which needs further study.

With the establishment of China's GEM in 2009, a large number of small and medium-sized enterprises with high growth potential come into the plate. Many of these companies want to use VC and debt financing to achieve their rapid growth. But the relationship among VC, financial leverage and firm performance has not yet reached a unified conclusion. In this paper we combine VC and financial leverage to study their impact on firm

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performance by selecting the GEM listed companies as the research sample, so as to help the enterprises to make the financing decision and ultimately improve their performance.

2. Literature Review And Hypotheses

2.1. The influence of VC on firm performance

What are the effects of VC on firm performance? At present, scholars hold two different views: one is that VC plays a positive role in promoting the performance of enterprises and most of the relevant literature supports this view. VC could not only provide the necessary funds for the development of the invested companies, but also enhance the value of the enterprises by participating in decision-making, improving the governance of corporations, optimizing the allocation of resources [4]. Jain and Kini [5] found that, although after the IPO the companies all had experienced decline in performance, but the operating performance of VC-backed companies was significantly better than non-VC-backed ones. Brav and Gompers [6] showed that if all the returns were equally treated, the return of VC-backed companies was better than the ones that did not have the background of VC in the five years after the IPO. Tan and Yang [7] pointed out that VC had a positive impact on the long-term performance of the independent innovative SMEs of China. Based on the data obtained from China's GEM during the period from 2009 to 2013, Xiu and Xia [8] reported that the exit of VC would have a negative impact on enterprise performance, enterprise performance would significantly decrease after the venture capital exited, which proved the positive effect of venture capital on improving enterprise performance from the side. Xu et al. [9] found that the entry and participation of VC can significantly improve the IPO performance of enterprises.

Another view is that, compared to non-VC-backed enterprises, there is no increase in the performance of VC-backed ones or the performance of these companies will be even worse. Using the data from Australian listed companies, Rosa et al. [10] reported that VC backed listed companies and non VC backed ones got the same profits within 2 years of post-IPO, the result showed that there was no obvious difference between the two types. Wang et al. [11] found that in the Singapore market, the operating performance of VC-backed firms was worse than that of non-VC-backed ones during the time of IPO and post-IPO. Besides, there was no significant difference between the two types of companies. Using the method of empirical analysis, Tan et al. [12] found that VC had no significant positive impact on IPO underpricing, listing costs, R&D investment of enterprises. In terms of long-term operating performance, excess returns, VC-backed firms were significantly worse than non-VC-backed ones. Hou [13] empirically tested the impact of VC and its characteristics on entrepreneurial performance from three perspectives of investment return, profitability and growth. The regression results showed that venture capital and its participation duration had negative effect on performance and profitability of the companies, and had no significant effect on the companies' growth.

As the GEM listed corporations are mostly companies with high growth potential, these companies are more likely to get the favor of venture capital institutions, so as to obtain the necessary capital and other value-added services provided by VC. What's more, the majority of the literature supports the view that VC contributes to the growth of the company and improve the performance of it, therefore we put forward the hypothesis 1:

H1: There is a significant positive correlation between VC and enterprise performance. That is, compared with the non-VC-backed enterprises, VC-backed ones have better performance.

2.2. The impact of financial leverage on firm performance

Although many scholars have studied the relationship between financial leverage and corporate performance, but they have failed to get a consensus, and the research conclusions are quite different. Some scholars believe that financial leverage is positively related to corporate performance. Debt financing could reduce the free cash