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# Effects of venture capitalists' participation in listed companies

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## Abstract

We empirically examine the effects of venture capital (VC) firms on VC-backed listed companies in Singapore. While previous studies have shown the VC value-added in lower underpricing and better post-IPO operational performance of VC-backed IPOs, we find the effects of venture capitalists' participation are very complicated. Most significantly, the post-IPO operating performance of VC-backed companies is inferior though they are less underpriced. The finding supports both the certification model and the adverse selection model. Furthermore, we find that IPOs backed by older VC firms perform better, supporting the grandstanding model that younger VC firms bring their portfolios to the market prematurely.

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## 1. Introduction

Venture capital (VC) is an intermediate external source of financing for small and medium-sized enterprises (SMEs). Extant VC studies generally agree that VC firms not only contribute funding but also provide value-added services to their portfolio companies. However, adverse selection and conflict of interests may bring negative effects to VC investments. In this study, we focus on the effects of venture capitalists'

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participation in IPO companies in an emerging market and provide a more realistic view through an empirical testing of models (certification/monitoring and adverse selection/grandstanding) on VC effects. Although previous VC research exists in developed countries (e.g., US and Europe), our study is one of the few empirical VC studies in the emerging markets.

Literature on VC-backed companies generally supports the VC certification/monitoring model. That is, VC firms add value to companies in which they invest by certifying them as the most promising ones, and monitoring through the whole process of company growth. For example, Lam (1991) uses a conceptual model to demonstrate the sources of value added by venture capitalists to their portfolios. At the same time, based on data of the US market, Megginson and Weiss (1991) report the certification role of VC firms in the IPO process. In addition, Lin (1996) finds a negative correlation between the shareholding of leading VC firms and their initial returns while Lerner (1994) reports the better timing of VC firms in the IPO of their portfolio companies. Furthermore, Jain and Kini (1995) observe that VC-backed companies exhibit superior post-IPO operating performance compared to non-VC-backed IPO companies, and Brav and Gompers (1997) discover higher long-term returns for VC-backed companies. These studies indicate that VC firms add value to the IPO process and post-IPO operating performance of issuing companies, as well as their long-term market performance.

On the other hand, Amit et al. (1990) theoretically propose the adverse selection problem when venture capitalists search for start-ups to invest in. Associated with asymmetric information, adverse selection means less capable entrepreneurs will choose to involve venture capitalists to share the risk while more capable entrepreneurs will manage their ventures without seeking for external participation. The conflict of interests between venture capitalists and entrepreneurs will also have post hoc effects. Gompers (1996) hypothesizes the “grandstanding” of young VC firms, as they are more likely to conduct IPOs prematurely to falsely signal their reputation and performance. Hamao et al. (2000) report a similar conflict of interests in a study on VC-backed IPOs in the Japanese market. They find deep underpricing of securities-affiliated VC-backed IPOs when the leading venture capitalist is also the leading underwriter.

In this study, we choose Singapore as the research setting, an emerging market with nearly twenty years of VC history to test these two models. The local VC market in Singapore began in 1983 and grew to a cumulative pool of US\$13.7b by 2001. Furthermore, we choose the Singapore VC market as the sample in this study because of its relatively large size and industry breadth among emerging markets. In terms of size, Singapore’s VC pool is the third largest in Asia, next only to Hong Kong and Japan (AVCJ, 1999). In terms of industry breadth, the industry distribution of VC-backed companies in Singapore is broader with a higher concentration in high-technology sectors (e.g., IT, electronics) compared with that in Hong Kong (AVCJ, 1999). Investigation in this emerging market can add insights to the understanding of VC mechanism, especially in environments outside of the United States.

As listed companies are obligated to disclose their background and operating data to the public, we focus on the VC’s influence on listed companies, as reflected by dif-

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