2nd Entrepreneurial Finance Conference

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Abstracts

Thursday, July 6th, 2017 / 11:00 – 12:30

Track 1.1: Investors & interest rates

> Implicit interest and financing

Authors: Franklin Allen, Meijun Qian & Jing Xie

Social or business connections create implicit interests between borrowers and lenders. We model how implicit interest influences credit allocation, cost, and renegotiation between the borrower and the lender in case of delinquency. The optimal solution illustrates that financing with implicit interest achieve three clear advantages compared to financing without implicit interest: lower financing cost, higher managerial efforts, and better economic outcomes for both the borrower and the lender. The models predictions are consistent with anecdotes and empirical evidence that financing through social and business network is prevalent and often associated with good economic results. The model also demonstrates that, if the social network mechanism triggers potential personal and physical collateral damage in case of delinquency, such financing would instead underperform financing through formal institutions.

> Do interest rates affect venture capital fundraising, demand and investments?

Authors: Cristiano Bellavitis & Natalia Matanova

We examine whether interest rates affect venture capital (VC) fundraising, demand and investments. Lower interest rates fuel VC fundraising by making VC funds more attractive to limited partners (LPs) compared to other asset classes. We present evidence that higher interest rates make venture capital "cheaper" compared to debt and, consequently, boost VC demand from entrepreneurs. VC investment activity is influenced by supply and demand dynamics. Investments increase at high interest rates especially when VC supply is commensurate or higher than VC demand. These results are statistically significant and economically meaningful.

> How wise are crowd? A comparative study of crowd and institutions in peer-to-business online lending markets.

Authors: Ali Mohammadi & Kourosh Shafi

Funding small businesses used to be the exclusive domain of angel investors, venture capitalists, and banks. Crowd have only recently been recognized as an alternative source of financing. Whereas some have attributed great potential to the funding provided by crowd ("crowdfunding"), others have clearly been more skeptical. We join this debate by examining the performance of crowd to screen the creditworthiness of small and medium sized enterprises (SMEs) compared with institutions in the context of new online peer-to-business lending markets. Exploiting the randomized assignment of originated loans to institutions and *the crowd in the online peer-to-business platform of FundingCircle, we find that crowd underperform institutions in screening SMEs, thereby failing to lend at interest rates that adjust for the likelihood of defaulting on a loan. Moreover, the underperformance gap of crowd compared with institutions widens with risky and small loans, suggesting that crowd lack the expertise to assess the risks or the incentive to expend resources to perform due diligence. Overall, our findings highlight when crowd face limitations in screening SMEs.*

Track 1.2: Business angels

> What drives the performance of angel-backed companies? A comparative analysis of alternative angel investment practices

Authors: Stefano Bonini, Vincenzo Capizzi & Paola Zocchi

This paper investigates the determinants of the performance of angel-backed companies by making reference to an original set of independent variables related to business angels' investment practices, either when investing alone or when co-investing together with other informal investors. Using a unique database with qualitative and quantitative information on over 1,570 deals made by about 1,420 business angels from 2008 to 2015, we have identified a sample of 111 angel-backed companies invested between 2008 and 2012, in order to investigate their survivorship and financial performance 3 years after the investment. The results show that both the performance and the probability of survivorship of investee companies are positively affected by the presence of angel syndicates and by the hands-on involvement of business angels, while are negatively affected by the monitoring effort, especially for lower experienced angels. Furthermore, also the equity infusion pattern does have an influence, in that angel investments should be made through a single monetary injection, rather than through multiple capital injections, in order to guarantee survivorship over time.

> Business angel investments: success factors and similarity

Authors: Svenja Jarchow & Barbara Stolz

This paper investigates the landscape of business angel investments in Germany. Business angels take an important role in the financing cycle of young companies. Providing smaller amounts of money than venture capitalists yet more than family, fools and friends, they can bridge the financing gap many young entrepreneurs experience after the first months of starting their company. Yet, business angels can provide more than money. In literature, business angels are commonly described as wealthy individuals providing financing to young companies. At the same time, they typically support entrepreneurs in early stages of developing the company, giving advice and participating in following early venture capital rounds. Usually, business angels were successful entrepreneurs themselves and they enjoy to pass on their knowledge and provide advice and experience.

Track 1.3: Crowdfunding

> Disentangling crowdfunding from fraudfunding

Authors: Douglas Cumming, Lars Hornuf, Moein Karami & Denis Schweizer

Using Kickstarter and Indiegogo, the two largest crowdfunding platforms, we conduct an exhaustive search of all fraud cases from 2010 through 2015, spanning nine countries. While fraud in this new financial market has been a concern of many regulators, it is arguably of even greater importance for the nascent industry itself. Should the crowdfunding market exhibit high levels of fraud, a new and potentially more efficient way of financing rapidly disappears from the stage again. It is therefore paramount to identify the *motivations and drivers of fraudulent behavior. We present first evidence that fraudsters in crowdfunding markets can be detected because of several specific characteristics: They are less likely to have engaged in prior crowdfunding activities, they are less likely to have a social media presence, and they are more likely to provide poorly worded and confusing campaign pitches with a greater number of enticements through pledge categories.*

> Kick-start your business – impression management in crowdfunding pitches

Authors: Sofie De Prijcker, Prabal Shresthaa & James Thewissena

To guarantee the success of a crowdfunding project, it is of utmost importance for entrepreneurs to present their business in the best possible light and to write a compelling pitch. In this regard, the paper looks into impression management tactis employed by entrepreneurs in their crowdfunding pitch to project optimism, certainty and commonality, to establish perception of competence and likability in the eyes of the potential funder. Furthermore, the analysis of impression management is divided into two contexts within a crowdfunding pitch–in the project description and in risk communication, to assess the importance of consistency in tone, and also to look into the dynamic aspects of tone in relation to successful implementation of impression management. The findings of the study provide strong evidence for effectiveness of various impression management tactics employed in a reward-based crowdfunding setting in influencing the outcome of funding campaigns. Furthermore, the results also indicate that funders react positively to consistency in tone within the pitch, however, increase in positive tone emphasizing on the outcome of the project while communicating risk was found to have a positive impact on funding outcome.

> Is wisdom of the crowd a positive signal? Effects of crowdfinancing on subsequent venture capital selection

Author: Michael Mödl

We examine the impact and signaling effects that prefunding has on subsequent venture capital funding rounds. The seed funding gap is still a major obstacle for the initiation of new ventures. Crowdfinancing – an innovation in the market for startup finance – could be a possible market-based option to partly close this gap. However, crowdfinancing cannot be regarded as a substitute for venture capital or business angel funding, e.g. since it is not likely to fully finance a new venture over time. It therefore appears important to study the interaction between crowdfinancing and more traditional forms of startup finance. Drawing on a choice experimental design and data on 5,280 decisions of 120 venture investors, our results indicate that "the crowd" generally is a negative signal for professional venture investors, but that they do not ignore positive signals sent by the crowd. We find causal evidence that crowd-investing (securities-based crowdfunding) is in general regarded as highly negative by venture capitalists, while high sums of (reward-based) crowdfunding, collected fast by startups with a B2C business model, can have a positive effect on VC managers' funding decisions. Our results also suggest that prior business angel investments significantly increase the likelihood of subsequent financing rounds. Theoretical and managerial implications are discussed.

Track 1.4: Initial Public Offerings

> The effects of stricter regulation on entrepreneurial IPOs

Authors: Peter-Jan Engelen, Michele Meoli, Andrea Signori & Silvio Vismara

This paper studies the impact of increased securities regulation on IPOs of entrepreneurial firms. We take advantage from the adoption of EU SOX-like provisions, staggered at different dates across European *countries, to test their influence on the economic trade-off associated with the going public decision. Starting from the population of European private firms during 1995-2012, we find on the one hand that the likelihood has decreased among small firms and high-tech and knowledge-intensive service (HTKIS) firms due to increased compliance costs, proportionally larger for small firms, and increased loss of confidentiality, more problematic for HTKIS firms. Consistently, we document a 7.6% and 9.1% decrease in the average Tobin's Q of small and HTKIS firms that do go public after the regulatory change. On the other hand, we find that enhanced disclosure has reduced IPO underpricing among small and HTKIS firms, with an average decrease of 9 and 8 percentage points, respectively.*

> Investor relations and IPO performance

Authors: Salim Chahine, Gonul Colak, Iftekhar Hasan & Mohamad Mazboudi

We analyze the value of investor relations (IR) strategies to the IPO firms. Firms that are less visible and have inexperienced management tend to hire IR consultants prior to the issue date. Such IR-backed IPOs also exhibit higher short-term performance in terms of lower cost of capital, higher price revision, higher underpricing, and better market liquidity. The IR consultants help create positive news coverage before the IPO event as reflected in a more optimistic tone of the media news articles. However, this optimism is negatively related to the long-term IPO performance. Furthermore, one year after the IPO date, the ownership percentage, the total number, and the quality of institutional investors of these IR-backed IPOs are much lower than the other IPOs. Finally, during such IR-backed public offerings, the participation ratio by the insiders of the IPOs is disproportionately higher. Thus, the IR consultants seem to facilitate the exit strategies by the insiders, which can explain the increased popularity of such IR programs in recent years.

> Know when to hold 'em, know when to fold 'em: lessons from Canada's venture exchange

Authors: Diego Amaya, Michael Brolley & Brian Smith

Do public markets provide a profitable means for investors to finance early-stage companies? Using data for small IPOs (<$2 million) in Canadian public markets, we examine both short-term and long-term returns of Capital Pool Companies (CPCs). CPCs are shell companies that seek and negotiate the acquisition of operating assets in a so-called qualifying transaction (QT). We find that the most profitable strategy is to follow the founders and invest in CPCs at the time of IPO and then liquidate soon after the QT. In contrast, investing in CPCs after the QT is unprofitable. Long-term returns are extremely right-skewed, with over 80% of CPCs earning negative long-term returns. A strategy of investing in 50 small new issues limits downside risk, while retaining some of the upside lottery-like returns.

Thursday, July 6th, 2017 / 14:00 – 15:30

Track 1.5: Debt

> The capital structure of business start-ups across Europe: the effect of a "fresh start" policy

Authors: Jürgen Hanssens, Marc Deloof & Tom Vanacker

We examine cross-country differences in the capital structure of start-ups in their initial year of operation, focusing on countries' "fresh start" policy—the possibility for bankrupt entrepreneurs to discharge their outstanding credit obligations. To do so, we employ a unique dataset of 2,849,997 start-ups from 26 European countries founded between 2005 and 2012. We find that time-invariant, country-specific factors are important determinants of start-ups' capital structure. We further document that start-ups use less debt if a "fresh start" is available in a country's personal bankruptcy laws. Using a difference-in-differences *approach to exploit country-level changes in the availability of a "fresh start", we also find that start-ups founded after the implementation of a "fresh start" policy use less debt than start-ups founded before the implementation of a "fresh start" policy. In sum, our results suggest that the possibility of a "fresh start" in a country reduces access to debt financing for start-ups.*

> Marketplace lending of SMEs

Authors: Douglas Cumming & Lars Hornuf

Marketplace lending refers to online platforms facilitating loans from individuals to private small and medium sized enterprises (SMEs). We conjecture that the information conveyed by the platform (ratings) plays a pronounced role in influencing the borrowing success of SMEs, and that more sophisticated financial information and issues of adverse selection are largely irrelevant in these markets. We introduce a first-ever dataset of 414 marketplace loans and track 8,236 online loan-days to test these propositions. The data examined provide strong support for the importance of simple ratings in influencing investor behavior. The data further indicate the importance of competing investment opportunities.

> Craft lending: the role of small banks in small business finance

Authors: Lamont Black & Michal Kowalik

This paper shows the "craft" nature of small banks' lending to small businesses when small banks face competition from large banks. Small banks have a greater ability to monitor their borrowers, but large banks have a lower cost of lending. In our theoretical model, an increase in large bank competition makes small banks especially valuable to intermediate-productivity borrowers. We analyze bank data using loan size as a proxy for borrowers' productivity and find results consistent with our "craft lending" hypothesis. Small banks increase their small business lending in the intermediate loan size category ($250,000 to $1 million) following large bank entry into their market. These findings suggest that this intermediate segment of the small business loan market is a niche for small banks competing with large banks.

Track 1.6: Contracts & exits

> Understanding the business angel's exit process: an exploratory study

Authors: Tiago Botelho, Colin Mason & Richard Harrison

Although there are a handful of studies on business angel investment returns, the business angel literature has given little or no attention to exits and the exit process. This is surprising given that a primary objective of investing is to achieve a financial gain through some form of liquidity event. Using the theory of planned behaviour (TPB) as an interpretative heuristic, we examine how exits happen: specifically, what are the motivations to seek an exit and to what extent are they planned or opportunistic? Based on multiple case studies in which business angels were invited to tell the story of their most recent exit(s) that generated a financial return the evidence suggests that the majority of exits are the outcome of planned behaviour. On the basis of this we propose a typology of angel-backed investment exits as the basis for identifying future directions for research and developing practical advice to angels on effective business practices.

> Optimal contracts with strategic exit of short-termists investors: a model

Authors: Guillaume Andrieu & Alexander Peter Groh

We analyze how entrepreneurs trade off short-termism of investors and the refinancing requirements of projects. We consider a conflict between project duration and financial constraints of investors. An entrepreneur endowed with an innovative project asks for seed and development stage capital from two *investors. It can happen that the seed investor is not be able to stay until the project's end. We consider that this event is not observable and introduce the possibility that the insider can take advantage of his own financial constraint to make strategic exits. Our results show that two situations are possible. In the first one, the project is never liquidated and the first investor sells his shares except if the project is eventually successful and he can stay. In the second situation, similar to a lock up contract, the venture is systematically liquidated even if successful except if the seed investor is able to stay. We compare both situations and discuss our results in comparison with investors that may not have such financial restrictions.*

>   Negotiating incomplete contracts: the role of relational governance in contractual design

Authors: Truls Erikson & Mirjam Knockaert

In this study, we examine how relational governance relates to the incompleteness of the contract entrepreneurs reach with their growth financiers. In particular, we explore how CEO's confidence in VC cooperation affects their mutual bargaining processes, and subsequently how these bargaining processes influence contract designs under various environmental uncertainty conditions. Specifically, we find that CEO's confidence in VC cooperation directly, and positively, affects the nature of contract designs, so the more confidence, the more incomplete contracts. We also find that rights-based bargaining negatively mediates the relationship between CEO's confidence in partner cooperation, and the nature of the contracts, so the more rights-based bargaining, the more comprehensive contract designs (that is, the less incomplete the contracts). Finally, we find that environmental uncertainty negatively moderates the relationship between rights-based bargaining and the nature of these contracts, so the more environmental uncertainty, the less incomplete contract designs. Implications for theory and practice are discussed.

Track 1.7: Equity crowdfunding

>   Investors' choice between cash and voting rights: evidence from dual-class equity crowdfunding

Authors: Douglas Cumming, Michele Meoli & Silvio Vismara

This is the first paper that investigates the corporate governance of firms raising equity capital through crowdfunding. Unique to this context, companies can set an investment threshold under which no voting rights are granted, making the issuance of A-class vs B-class shares depending on the decision of individual investors. Using a sample of 491 initial equity offerings on the UK platform Crowdcube in the period 2011-2015, we find that a higher separation between ownership and control rights lowers the probability of success. In particular, our evidence shows that, differently from small investors, sophisticated investors care about corporate control and often bid exactly the A-class threshold.

>   Equity crowdfunding: first resort or last resort?

Authors: Xavier Walthoff-Borm, Tom Vanacker & Armin Schwienbacher

While research has focused on the factors that impact funding success on crowdfunding platforms, we lack a detailed understanding of the factors that drive firms to search for crowdfunding. Drawing on the pecking order theory, we argue that firms list on equity crowdfunding platforms as a last resort, that is, when they lack internal financing and debt capacity. We show that firms listed on equity crowdfunding platforms are less profitable, often have excessive debt levels and have more intangible assets, relative to comparable firms, all of which is consistent with the pecking order theory. We discuss the implications for theory and practice.

>   Dynamics of investor communication in equity crowdfunding

Authors: Gregor Dorfleitner, Lars Hornuf & Martina Weber

In crowdfunding, start-ups can voluntarily communicate with their investors by posting updates. We investigate whether start-ups strategically use these updates, which were previously shown to increase investments during the funding period of a campaign. To this end, we use hand-collected data of 751 updates and 39,036 investment decisions from the two major German equity crowdfunding portals Seedmatch and Companisto. We find evidence for a strategic communication behavior of start-ups using equity crowdfunding portals. During the funding period, start-ups post updates with a higher frequency and use specific linguistic devices. Furthermore, the probability of an update during the funding period increases with a strong competition of other contemporary crowdfunding campaigns.

Thursday, July 6th, 2017 / 16:00 – 17:00

Track 1.8: Innovation

>   Does political corruption impede firm innovation? Evidence from the United States

Authors: Qianqian Huang & Tao Yuan

We examine how local political corruption affects firm innovation in the United States. We find that firms headquartered in more corrupt Federal Judicial Districts are less innovative. The negative effect is greater for firms operating more geographically concentrated. We identify two possible economic channels through which corruption may affect innovation: disincentive effect and culture effect. We show that the negative impact of corruption on innovation is stronger for firms that are not financially constrained and for firms located in areas with lower local religiosity. Overall, our results indicate that local political corruption impedes corporate innovation.

>   Firms' innovation strategy under the shadow of analyst coverage

Authors: Bing Guo, David Pérez-Castrillo and Anna Toldrá-Simats

We study the effect of analyst coverage on firms' innovative behavior by considering the different strategies that allow firms to incorporate innovations: internal R&D, investments in corporate venture capital (CVC) funds, and acquisition of other innovative firms. Using data of US firms from 1990 to 2011, we find evidence of two opposite effects of financial analysts. On the one hand, firms followed by more financial analysts are more likely to cut R&D expenses in the future, due to an earnings pressure effect. On the other hand, more analyst coverage increases the likelihood of firms investing in CVC funds and acquiring other innovative firms. We show that this positive effect is mainly a direct effect of financial analysts which we attribute to their monitoring role. We address endogeneity with an instrumental variables approach, and a difference-in-difference strategy where exogenous variation in analyst coverage comes from brokerage house mergers.

Track 1.9: Funding dynamics

>   Entrepreneurial manipulation with staged financing

Author: Chris Yung

Finance is staged in environments like venture capital. It has been argued that staging has a drawback: entrepreneurs direct effort to manipulating appearances so as to keep funds flowing. In contrast, this paper finds that manipulation can be either higher or lower com- pared to non-staged financing. Also contrary *to the argument given in the literature, manipulation is non-monotonic in leverage. Finally, behavior in early rounds induces a kind of "manipulation persistence" so that total manipulation is path-dependent.*

> The financing dynamics of newly founded firms

Authors: Julia Hirsch & Uwe Walz

Little evidence exists on the financing decisions of newly founded firms or on the financing dynamics of these firms over their life cycle. We aim to help filling this gap by investigating the financing dynamics of 2,456 French manufacturing firms founded between 2004 and 2006 through their legally required and reported financial statements. Because we observe significant heterogeneity in the financing decision in the firms' founding year, we focus on analysing whether these differences widen, persist, or converge by using different convergence concepts. We identify a persistence-cum-convergence pattern. We find the existence of β-convergence (implying that e.g. firms with lower initial levels of debt accumulate more debt over time) but not of σ-convergence (i.e. we observe an increase in the cross-sectional dispersion of the financing structure). We also show that the dynamics of financing matter for the growth path of the firms.

Track 1.10: Venture capital

> The impact of venture capital monitoring in Europe

Authors: Massimo G. Colombo, Diego D'Adda, Paolo Malighetti, Anita Quas & Silvio Vismara

In this paper we aim to empirically test the monitoring effect of Venture Capital financing on portfolio companies. We exploit the introduction of a new airline route between investor and investee locations as an exogenous shock lowering the cost of monitoring activities performed by a venture capitalist. Using a sample of 9,564 investments by lead VC investors in Europe, we test how this treatment affects portfolio companies' performances in terms of the likelihood of being listed or acquired, the number of patents, the number of employees and the amount of sales. Our results show that VC monitoring has a positive and economically relevant effect on European portfolio companies along most of these performance measures, but with different time horizons.

> When can government venture capital funds bridge the equity gap?

Authors: Yan Alperovych, Alexander Peter Groh & Anita Quas

Several papers find that government venture capital (GVC) funds do not add (much) value to their investees, underperform their private peers, or crowd out private investment. However, "bridging the equity gap" is allegedly a major objective of public initiatives in the market for start-up financing. This paper addresses the conditions under which GVC funds may fulfill this mission. Our data reveal that the competitiveness of a region where a GVC fund is located strongly affects its success. Furthermore, potential collusion and regulatory capture hinder the likelihood of success of GVC-backed start-ups. Nevertheless, GVC funds can achieve their objectives if they gain specific investee-industry experience and learn from their private peers through syndicated transactions.

Friday, July 7th, 2017 / 09:00 – 10:30

Track 2.1: Family & friends, personal finance

> Are family and friends the wrong investors? Evidence from U.S. start-ups

Author: Luana Zaccaria

This paper investigates the effects of funding from family and friends (i.e. informal funding) on start-ups' subsequent access to venture capital. I retrieve information on young U.S. firms' financing activity from a novel dataset based on private placements filings (Form Ds). To address potential endogeneity issues, I use an instrument that hinges on founders' family size as an exogenous constraint on the supply of informal funds. My results show that informal finance significantly reduces the probability of future financing events. I provide suggestive evidence that this is due to conflicts of interests between informal stakeholders and professional investors.

> The effect of personal financing disruptions on entrepreneurship

Author: Tobin Hanspal

I show that disruptions to personal sources of financing, aside from commercial lending supply shocks, impair the survival and growth of small businesses. Entrepreneurs holding deposit accounts at retail banking institutions that defaulted following the financial crisis reduce personal borrowing and are consequently more likely to exit their firm. Exposure to the corresponding investment losses from delisted publicly traded bank stocks strongly reduces the rate of firm survival, particularly for early-stage ventures. At the intensive margin, owners who remain in business reduce employees after personal wealth losses. My results suggest that personal finance is an important component of firm financing.

> Friends and family? How young entrepreneurial firms really fund their assets

Authors: Rebel Cole & Tatyana Sokolyk

In this study, we present new evidence from the Kauffman Firm Surveys on the financing of privately held entrepreneurial firms during their first eight years of operations. At start-up, owners' equity is by far the most important source of capital, but accounts for only 35% of total start-up capital. In addition, more than 55% of firm owners borrow on personal accounts from banks and credit cards, providing about 15% of start-up financing. As firms mature, they decrease the use of both owner equity and borrowed equity, but increase the frequency of business credit, which highlights the importance of external debt financing, such as bank lending, to start-up firms. Finally, we document the critical importance of trade credit financing for young entrepreneurial firms, which increases dramatically after the first year of the firm's operations, from about 15% of capital at start-up to more than 50% in years three through eight.

Track 2.2: Buyouts

> The role of bank networks in leveraged buyout financing

Authors: Yan Alperovych, Anantha Krishna Divakaruni, Sophie Manigart & Miguel Meuleman

This paper investigates bank networks in the syndicated LBO market and their impact on lead bank selection and terms of LBO financing. Bank networks facilitate the flow of information and resources, and influence LBO financing in at least two distinct ways. First, a bank's network position reflects its ability to mitigate agency conflicts between borrowers (PE firms and targets) and the loan syndicate. Second, the bank's network position helps reduce information asymmetries within the syndicate. We analyze a unique sample of 2,332 LBOs comprising 5,970 syndicated loans issued in the United States between 1991 and 2012. Our results show that borrowers tend to choose better-networked banks, as doing so reduces their *financing costs as reflected in the lower loan spreads, maturities and collateral requirements. These results hold even after controlling for prior relationships between banks and borrowers.*

> LBO performance in emerging countries: a comparative study in Latin America and Asia

Authors: Alain Chevalier & Aurélie Sannajust

We extend our worldwide research on private equity by studying the drivers of LBO operating performance in emerging countries (Asia and Latin America). We select a large set of candidate drivers (financial, governance, macroeconomics, microeconomics, institutional variables) and we analyze their effects on performance over the short and longterms. To conduct our study, we use Capital IQ, Thomson One Banker, World Bank as databases. We contribute to the current literature by doing an investigation of the impact of macroeconomics factors and institutional drivers (political stability, rule of law and regulatory quality) on the buyout performance. Positive and significance results are obtained. We use a sample of 248 LBO transactions, which occurred between 2000 and 2011. Our results show that GDP growth and political stability are important drivers that significantly contribute to generate performance in LBOs.

> Do buy and build strategies increase illiquidity of private equity investments?

Author: Benjamin Hammer, HHL Leipzig Graduate School of Management

Increasing holding periods are a notable trend in private equity and a concern to limited partners because they tie up committed capital. I investigate whether the frequent use of Buy and Build (B&B) strategies can explain this trend. I find that B&B increases holding periods by up to 29%, which is robust to different identification strategies including the application of a survival-time treatment effect estimator. Further investigating channels through which B&B increases holding periods, I iden- tify factors that can mitigate but not avoid prolongation. Thus, my fndings point at increasing illiquidity risk as an unintended "dark side" of B&B strategies.

Track 2.3: Venture capital

> Does religiosity influence venture capital investment decisions?

Authors: Justin Chircop, Sofia Johan & Monika Tarsalewska

Using a sample of 91,020 U.S. VC investments we study whether the religiosity of the VC firm influences investment decisions. Prior literature establishes a positive correlation between religiosity and risk aversion, thus we posit that VCs located in more religious counties make less risky investments. We find that VCs located in more religious areas are more likely to be involved in staging, syndication, and have a higher propensity to invest in later and expansion stages of the portfolio company. We further find that the effect of VC religiosity is stronger when the VC is located in a county with more Protestants relative to Catholics. We also find that higher VC religiosity is related to a higher propensity for the VC to exit the investment via IPO. Taken together our results suggest that VCs located in more religious counties are more risk averse and their investments tend to be of better quality.

> Better safe than sorry

Authors: Carolin Helmreich & Eva Lutz

We investigate the impact of trust among nations on the formation of multinational venture capital syndicates. Our dataset, based on Thomson ONE, contains 9449 triads among venture capitalists, their syndicate partners, and portfolio firms. We find bilateral trust has a significant, positive impact on the probability of cooperation in a syndicate. The magnitude of this relationship depends on the status of *venture capital markets. The relevance of bilateral trust to the probability of cooperation decreases for investments in large venture capital markets with many deals. Contrary to findings of venture capitalists' constricted scrutiny in boom phases, we find that trust becomes more relevant to cooperation during upswings of deal activity in the target market. In line with research citing access to capital as a major reason for syndication, recent capital abundance in the lead's or partner's market reduces the impact of bilateral trust on the probability of cooperation.*

> The effect of venture capitalists straying from their industry comfort zones

Author: Tyler Hull

I analyze the effect that investing outside of a venture capitalist's industry comfort zone has on exit performance. My findings are as follows. Venture backed investments are significantly more likely to have successful exits when the backing venture capitalists invest in an investment firm within their preferred investment industry. I also show that when a venture capitalists invests outside of their preferred investment industry the negative effect of doing so can at least be partially overcome by co investing with another venture capitalist that has the same investment focus as the investment firm. The negative effect of an investment outside of the venture capitalists preferred investment industry is also shown to be more pronounced the greater the difference between the venture capital's industry investment focus and the industry of the investment firm. Out of industry comfort zone investment is also shown to have a deferential effect depending on the investment industry, more specifically, a positive effect is shown in less specialized industries and a negative effect in more specialized industries. I also show that as venture capitalist become more experienced the cost of investing outside of their industry specialization becomes greater. Using yearly changes in venture capital dry powder as an exogenous shock to a venture capitalist's willingness to invest outside of their industry comfort zone, additional support is given to the negative effect of investing outside a venture capitalist's industry comfort zone. Overall, my results indicate the importance of venture capital industry specialization and that those venture capitalists that invest outside of their industry focus will have a negative effect on exit success likelihoods, which becomes more severe the more specialized the industry is and the greater the difference between the investment industry and the preferred investment industry.

Friday, July 7th, 2017 / 11:00 – 12:30

Track 2.4: Private equity

> Style drifting in private equity: when are drifts implemented and how do they affect investment performance?

Authors: David Rody & Reiner Braun

We assess the determinants and performance implications of investment style drifts in private equity, using a unique dataset of 12,426 portfolio company investments by 340 fund managers. Our analysis overcomes exiting limitations twofold. First, we use cash flow data for a precise performance measurement. Second, we employ a sophisticated measure of style drift. We find that experienced and large management firms drift less and that market conditions have influence on drift activity as well. Our performance investigation shows that style drifts have a significant positive impact on the performance of buyout fund managers, indicating a certain diversification effect of this investment practice.

> Working for divergent principals: effects of private equity on employment practices in family firms

Authors: Jeroen Neckebrouck, Sophie Manigart & Miguel Meuleman

This research increases understanding of agency theory by exploring the influence of divergent principal interests in private firms. Investigating unique panel data on employment levels and employment terms in private equity backed family firms (from 1996 to 2013), findings reveal that, when private equity investors acquire minority positions, family control strongly weakens the positive impact of private equity on employment levels. Alternatively, when private equity investors acquire full control, employment levels increase more in previously family controlled firms compared to nonfamily firms. Results further show that neither majority nor minority private equity investments induce significant changes in employment terms such as wages or the usage of temporary contracts, yet highlight some important selection effects. These results hold broad implications for family firms, private equity investors and policy makers.

> Buy and build strategies in private equity: boost or transformation?

Authors: Benjamin Hammer, Heiko Hinrichs & Denis Schweizer

This paper presents a first examination of how private equity (PE) fund managers actively develop their portfolio companies through so-called "buy-and-build" strategies (B&B), in which a portfolio company serves as a platform for add-on acquisitions. We argue that, because of holding period constraints, PE fund managers face a trade-off between the quantity and complexity of add-on acquisitions. Thus, in comparison to their peers, portfolio companies could do more, but similar, acquisitions (the "boost hypothesis") or as many, but different, acquisitions (the "transformation hypothesis"). Using a control group of non-PE-owned companies, we find strong support for the "boost hypothesis." Difference-in-differences estimates show that the probability of an acquisition is almost doubled after PE entry. However, we find no statistically significant differences in the complexity of acquisitions between PE- and non-PE-owned firms. This holds true for several complexity measures of domestic and cross-border acquisitions. Finally, we investigate whether buyers pay a premium for this acquisition boost. We find that deals with B&B yield significantly higher multiples at exit, with this effect being driven largely by cross-border B&B strategies.

Track 2.5: Financial crisis

> The financial crisis and risk assessment: shifts in demand, supply and character

Authors: Nicolas Legendre, Miwako Nitani, Francois Eric Racicot & Shantanu Dutta

Examining the commercial lending market for Canadian SMEs during the 2007-2008 financial crisis, this study reports lenders' escalated aversion towards risk associated with research and development, exports, inexperienced managements and continual use of bank loans for operations. This, combined with a shift in the character of loan demand: from loans sought for growth to those sought by cash-limited firms for survival, could have resulted in a severe contraction of credit. However, commercial banks appear to have avoided such a contraction by being more tolerant to young firms and firms with high degrees of leverage (if they had otherwise low risk operations). As a result, a significantly higher loan application approval rate was observed during the crisis. This study argues that the Canadian financial sector's relatively low exposure to the subprime mortgage market, with banks being able to maintain relatively stable Capital Tier I ratios during the crisis, helped avoid a credit contraction. At the same time, it poses questions regarding justification for the federal government's intervention in the market, one meant, at taxpayer expense, to isolate SMEs from the perceived liquidity shock.

> The role of private versus governmental venture capital in fostering job creation during the crisis

Authors: Annalisa Croce, Jose Martí & Carmelo Reverte

As one of the major side-effects of the financial crisis was a significant reduction in employment, in this paper we analyze whether firms backed by venture capital (VC) generated a higher employment growth than that of a matched control group of non-VC-backed firms during a period of crisis. Based on a sample of Spanish 408 early stage firms that received a first round of VC financing during the period 2005-2011 and a control group of 1,074 non-VC-backed peers, our results reveal that VC-backed firms generate higher employment growth relative to non-VC-backed peers for both investments carried out before and after the crisis started. Nevertheless, this pattern changes when we distinguish between private (PVC) and governmental (GVC) VC-backed firms. We find that the impact of the former on employment growth is higher in investments completed during the crisis than in those closed before whereas the impact of the latter is only significant in the case of investments carried out before the crisis. This finding could be attributed to the higher value-added and monitoring exerted by PVCs as compared to GVCs, which is especially important to overcome the negative consequences of the crisis.

> Productivity growth in the financial crisis: evidence from a sample of entrepreneurial firms

Authors: James R. Brown, Gustav Martinsson & Christian Thomann

We study how the financial crisis affected financing decisions and productivity growth using detailed administrative data covering essentially the entire population of entrepreneurial firms in Sweden during 2000 to 2012. Firm-level productivity growth slows significantly following the onset of the crisis, particularly among firms with higher financing costs in the years leading up to the crisis. As borrowing costs rise in the crisis, firms with high ex ante interest costs shift away from long term debt, increasing their reliance on both short term debt and external equity issues. Our findings show the sharp increase in borrowing costs in the financial crisis exacerbated the ongoing productivity slowdown and changed the way smaller entrepreneurial firms finance their real activities.

Track 2.6: Bank lending

> Discouraged borrowers and the case of informal turndowns

Authors: Anoosheh Rostamkalaei, Allan Riding & Miwako Nitani

Drawing upon the survey of the UK Small- and Medium-Sized Enterprise Finance Monitor (2011-2015), this research seeks to add to our understanding of mechanisms through which entrepreneurs may be discouraged from seeking external sources of finance. The paper examines the role of informal turndown: a situation in which a potential loan applicant is verbally informed by a bank about a probable rejection if a formal application is made. The research finds that entrepreneurs who are in more need of external finance and more established firms are more likely to suspend formal loan applications through informal talks with their banks rather than being discouraged by their own judgment. The paper also discusses the mechanism of risk rating as an efficient tool in discouraging bad borrowers from pursuing loan applications.

> Local banking development and the use of debt financing by start-ups

Authors: Marc Deloof, Maurizio La Rocca & Tom Vanacker

We investigate the effects of local banking development on the use of debt financing by start-ups for a large sample of Italian start-ups, controlling for endogeneity. We find that start-ups use more debt financing if they are located in a province with more bank branches relative to population. The effects of bank branch *density are not different for national banks versus local cooperative banks. However, the presence of more foreign banks in a province reduces the use of debt financing by start-ups. Taken together, our study provides new and nuanced evidence on the role of local banking development for the financing of start-ups.*

Any questions or requests? Don’t hesitate to contact the conference organizers via entfin@vlerick.com.