

# Venture capital increases a startup's chances of issuing stocks or finding a buyer

 [blogs.lse.ac.uk/businessreview/2016/02/01/venture-capital-increases-a-startups-chances-of-issuing-stocks-or-finding-a-buyer/](https://blogs.lse.ac.uk/businessreview/2016/02/01/venture-capital-increases-a-startups-chances-of-issuing-stocks-or-finding-a-buyer/)

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An ultimate challenge for technology entrepreneurs is the need for capital to continue to innovate, sustain, and commercialise their innovation. The considerable risks associated with the technological feasibility, business model credibility, and product or service viability severely limits access to capital, yet angel investors and venture capitalists fill this need by investing in startups in exchange for an equity stake in the company. Does private equity, in fact, provide value-added services by influencing startup innovation and commercialisation beyond mere capital infusion? While prior research has studied contributions from venture capital investments, we investigate whether the contributions from active engagement differ between angels and venture capitalists (VCs).

In our [study](#), we found out that investment by both angel groups and VCs in early stage startups provide an equivalent impact to accelerate their innovation rate — prior research to date has solely attributed such impact to venture capitalists. However, when investigating the impact of innovation or the likelihood of successful commercialisation, our research indicate that VC influence is significantly superior compared to that of angel groups.

Technology startups are notable for the amount of cash they require to move from inception to their early stages, and rely heavily on external financing provided by angels and VCs. Over the past four decades private equity investments have played a significant role in developing technology startups to catalyse innovation and entrepreneurial growth. In addition to capital infusion, the ways in which private equity investors actively engage founders through strategic counsel around development and production, leverage their industry network, and connect them to key management talent provide value-added benefits that fuel the innovation process in technology startups. With the growing access to alternative sources of private equity, entrepreneurs have a choice between sources of private equity that might be guided by the terms of the financial offering, or by the value-added benefits each may offer. Entrepreneurs incur a huge cost to obtain private equity investment so understanding the relative contribution of angels and VCs and what value they might bring to the startup has considerable practical importance.

Financing by angels and early stage VCs tend to concentrate on the initial stages of startup development where the risks associated with innovation are highest. In 2013, 86 percent of all angel investment and 36 percent of all VC investment was focused on early stage startups. While both angels and VCs are private equity investors they are dissimilar in terms of the investment structure and governance requirements. For instance, angels and VCs differ significantly in their governance approach with angels obtaining weaker control rights than do VCs. The more relaxed governance of angels may undermine the ability to influence the innovation process, while VCs with strong control rights can more easily move the startup toward successful innovation outcomes. However, stringent control rights have also shown to create conflicts between VCs and founders, which may negatively impact the likelihood of successful innovation. Given that angels invest their own money, they are unconstrained by the time-oriented performance-based compensation omnipresent in the VC market. This suggests that angels tend to have a longer-term investment horizon that may allow them to be more open to experimentation and show higher tolerance for early stage innovation failures compared to VCs. So, there are sound rationales to expect that there are differences in the ability of angels and VCs to nurture startup innovation and commercialisation.

Our empirical investigation disentangles the impact of angels and VCs by comparing the innovation growth and commercialisation in technology startups that received investment from angel groups and VCs. The key takeaway is that compared to angel financing, VC financing does not increase innovation rate but VCs significantly enhance the innovation impact and commercialisation of startups through IPOs and acquisition. This study provides the first evidence diagnosing how VCs and angel groups differentially influence firm outcomes. Policy makers, through venture capital programs, often consider angel finance differently from formal VC finance. VCs traditionally draw a

greater attention from policy makers. We believe our study has important policy and managerial implications for technology entrepreneurs seeking to understand the relative impact of angels and VCs in catalysing innovation.

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Notes:

- This post is based on the paper [A comparison of the effect of angels and venture capitalists on innovation and value creation](#), *Journal of Business Venturing*, Volume 31, Issue 1, January 2016, Pages 39–54.
- This post gives the views of its author, not the position of LSE Business Review or the London School of Economics.
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