

Patents as Signals for Startup Financing[†]

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Abstract

We examine the role of patents as signals used to reduce information asymmetries in entrepreneurial finance. A theoretical model gives conditions for a unique separating equilibrium in which startup founders file for patents to signal invention quality to investors, as well as appropriating value. The theory allows for heterogeneous investors and examines the optimal match of different types of startups, as defined by the quality of their technology, to investors who differ in the amount of non financial capital they provide. The empirical analysis is consistent with the model's predictions using a novel dataset of Israeli startups that received external funding during the period 1994–2011.

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