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## Sinners or Saints? Top Underwriters, Venture Capitalists, and IPO Underpricing

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### Abstract

This paper examines strategic interactions between venture capitalists (VCs) and top underwriters in the IPO process. We test two contrasting hypotheses: certification and rent extraction. On the one hand, the joint involvement of VCs and top underwriters can amplify their certification effect, reducing IPO underpricing. On the other hand, the rent extraction incentives of VCs and top underwriters, particularly in a repeated dealing context, can increase underpricing. We test these contrasting effects on IPO underpricing in the cross-section and around two regulatory shocks. First, VC-backed IPOs, VC-backed deals with top underwriters, and deals with stronger VC-underwriter ties exhibit greater underpricing. The cross-sectional results continue to hold in two-stage least squares estimation with geographical instruments. Second, the 2012 JOBS Act decreased disclosures by issuers and increased informational asymmetry. We find that IPO underpricing increased among VC-backed IPOs involving top underwriters after the JOBS Act. Third, a 2003 NASD rule limited explicit rents that may be extracted from preferential allocations of new IPO issues. We find that VC-backed IPO underpricing declined after the shock, and the effect was concentrated among VC-backed deals involving top underwriters and VCs with ties to underwriters. Importantly, we find no effect of top underwriters alone unless a VC is also involved. The observed decline in IPO underpricing cannot be explained by analyst involvement or the passage of Regulation FD. Moreover, repeat dealing between large institutions and underwriters similarly increases underpricing, but the effect does not explain the role of VC-underwriter ties and does not decline after the 2003 shock. Overall, our results support rent extraction, shed new light on the effects of VC backing, underwriters, and institutions on IPO underpricing, and emphasize the role of strategic interactions between them in the post-dot-com period.

**Keywords:** IPOs, Venture Capital, Underwriters, Institutional Buyers, Repeat Dealing, Conflicts of Interest, Underpricing

**JEL Classification:** G30, G32, G38

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