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Angels and venture capitalists in the initial public offering market

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Abstract

In this article, we examine angel investors and venture capital investors to determine how they interact in the market for small firm equity investment. We first generate a novel dataset of firms going through their initial public offerings and using the disclosures required by the Securities and Exchange Commission, classify firms having angel investors, venture capital investors, or both angel and venture capital investors. We find that the location, industry, and timing of firms backed by these different investor groups are strikingly different. We then compare the post-IPO operating performance of the firms in our sample for backed versus unbacked firms and find a significant difference for venture-backed firms, but not for angel-backed firms. For a subset of firms with angel and venture capital backing, we find some complementarities in the investment of angel and venture capital investors. However,

on the whole, our results suggest that angel investors and venture capital investors serve different sets of firms who need to obtain outside equity financing.

Keywords:

business angels | venture capital investors | initial public offerings | underwriters

Notes

1. See, for example, Megginson and Weiss (1991), Jain and Kini (1995), and Brav and Gompers (1997).

2. Survey papers concerning angel investors include Freear, Sohl, and Wetzel (2002) and Wong (2002).

3. For a review of angel data sources in the US, Canada, and the UK, see Mason and Harrison (2008).

4. We recognize that this screen will eliminate a disproportionate number of angel-backed IPO firms since we expect that most angel-backed firms will be smaller than other IPO firms. However, since penny stocks have different disclosure requirements, we eliminate these potentially problematic firms to ensure a consistent sample.

5. While we recognize that angel groups may in fact be limited liability partnerships (LLPs), our technique gives us a reliable lower limit on how many angel investors make investments in these firms that go public. We estimate that this technique categorizes approximately 4.2% of firms in our sample as being venture backed when in fact they may be backed by angel groups which are LLPs.

6. Figure 1a includes all firms with angel and venture backing as well. The results are not significantly altered if we remove the firms that have both angel and venture capital backing.

7. Seven Steps to Heaven, by Paul B. Brown, October 1, 2001, Inc.com.

8. We thank Jay Ritter for making the underwriter ranking data available from Loughran and Ritter (2004).

9. We group firms with angel backing plus venture capital backing into the venture-backed group, although our results are not sensitive to this grouping. The average underwriter rank for firms with both angel and venture capital backing is 8.29, a figure that is not significantly different from firms with only venture capital backing.

10. We group the firms backed by both angels and venture capitalists with the angel-backed firms. However, our results are not significantly impacted by this grouping.

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