A reverse takeover as an exit strategy of venture capital: Korean evidence

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ABSTRACT

We investigate the characteristics of firms that choose between three different methods, IPOs, sellouts, or reverse takeovers, to obtain exchange listings using Korean data over the period of 2000–2010. We document that VC-backed firms tend to choose reverse takeovers rather than IPOs or sellouts to go public after controlling for other determinants. We also find that VC-backed reverse takeover firms have higher leverage, lower profitability, and higher information asymmetry than VC-backed IPO firms. The results suggest that venture capital uses a reverse takeover as an alternative exit method from their portfolio firms since reverse takeovers constitute a fast and low-cost going-public mechanism. We then find that reverse takeover firms perform worse than IPO firms over the long term regardless of whether they are VC-backed or not.

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1. Introduction

Entrepreneurs and venture capitalists can exit fully or partially from their investments in private firms by a desire to satisfy their liquidity demands or by the need to raise capital in either of two main ways: initial public offerings (IPOs) or selling the firm to another company. In an IPO, they sell off a portion of their outstanding equity, but the entrepreneur retains significant ownership and control of the firm even after the IPO. In a takeover by a publicly-traded acquirer (sellout), they sell the private firm to an acquirer, in which case they divest most of their equity holdings in the firm, with the entrepreneur giving up the control of the firm to the acquirer. The growth of venture capital in U.S. markets tends to be ascribed to the availability of these exit strategies. However, if financial markets are underdeveloped or regulations are stricter unlike in the U.S., venture capitalists can have a hard time implementing IPOs or takeovers as their exit strategies from private firms. Taking a firm public via a traditional IPO can be a complex, expensive,