Access to financial capital is an important determinant of new firm survival and success. Drawing upon the literature on human capital and signaling theory, a series of hypotheses were proposed to disentangle the complex relationships among entrepreneurial human capital, a startup’s benefit offerings and the probability of its obtaining early-stage external financing. Analysis of the results obtained on a sample of 2791 firms in a longitudinal panel dataset support most of the hypotheses. In particular, a startup’s collective benefit offerings have an accelerating positive effect on the probability of its obtaining early-stage external capital. These findings imply that entrepreneurial human capital and a startup’s benefit offerings signal the startup’s underlying quality, which in turn affects investor decisions.

Hypotheses

Development of the hypotheses that follow is built upon signaling theory (Spence 2002) and human capital theory (Becker 1964; Wright, Coff, and Moliterno 2014). Human capital is valuable and rare for a firm, because individuals bring unique knowledge, skills and abilities, particularly highly specialized expertise (Barney 1991; Coff, and Kryscynski 2011; Hatch, and Dyer 2004). A firm with superior human capital can create greater economic value when it accesses and utilizes employees’ knowledge, skills and abilities. In deciding whether or not to fund a startup, external investors rely on the quality signals of entrepreneurial human capital, including education, industry and startup experiences.

Hypothesis 1a: The generic human capital of the founders will increase the probability that a startup receives external financing.

Hypothesis 1b: The industry experience of the founders will increase the probability that a startup receives external financing.

Hypothesis 1c: The startup experience of the founders will increase the probability that a startup receives external financing.

Next, the startup’s benefit offerings, as a valuable HRM practice, positively influence the probability of receiving external financing. Startups need to offer various benefits to attract, retain and motivate key personnel so as to create and maintain superior human assets. The provision of a combination of various benefits sends strong signals to external investors that the startup aims to enhance its human capital and motivate employees. The adoption of these HRM practices indicates that firms appreciate and support employees’ contributions (Jiang, Lepak, Hu, and Baer 2012).

Hypothesis 2a: The HRM practices adopted by a startup will increase the probability that a startup receives external financing.

Hypothesis 2b: The HRM practices adopted by a startup will have an accelerating effect on the probability that a startup receives external financing.

Methods and Results

In this study, the hypotheses were tested with a sample of 2791 firms in the longitudinal panel database from the Kauffman Firm Survey (KFS). All variables were from the confidential KFS dataset provided by the National Opinion Research Center (NORC). The dependent variable external financing is measured by use of a dichotomous variable. The first independent variable, entrepreneurial human capital, is measured using three indicators – education, industry experience, and startup experience. The second independent variable, benefit offerings, is measured using a composite sum of seven indicators and was also centered in the regression analyses. A comprehensive set of control variables was also included in our analysis.

Logistic regression analyses were used to investigate the determinants of early-stage external financing of startups. The base model in Table 1 included all the control variables. Independent variables were subsequently added in the full models. The analysis results support most of the hypotheses. However, the entrepreneurial industrial experience working had no impact on the probability of receiving external capital, which implies that this important signal of entrepreneurial human capital is unnoticed by external investors.

Discussion

The undervaluation of industry working experience might contribute to the “market for lemons” adverse selection in the capital market (Akerlof 1970; Krause 2016). Because access to external capital plays an important role in new firm survival and success, our in-depth analysis of the determinants of early-stage external financing reveals a dilemma created by the undervaluation of some signals in the external financing market.

In business practice, entrepreneurs without startup experience should be better equipped with regard to training on private equity financing. In the context of early stage financing, entrepreneurs need to send clear signals about their capabilities and actions that might otherwise go unnoticed by potential investors. External investors need to interpret positively not only the entrepreneurs’ startup experience, but also their other characteristics, such as industry working experience.

References


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