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Executive Ownership and Control in Newly Public Firms: The Role of Venture Capitalists

by Malcolm Baker and Paul Gompers

Abstract

We study the implications of CEO equity ownership for incentives and control in a sample of 1,011 newly public firms. Before an initial public offering, equity investments by venture capitalists reduce CEO ownership by about half, from an average of 35 percent to 19 percent. Venture capitalists narrow this difference by granting options, reducing secondary sales, and lowering the dilution by primary shares, but a gap in post-IPO CEO equity ownership remains. The effect of this lower ownership on incentives depends upon the measure employed - the dollar sensitivity of CEO pay to firm value is lower in venture firms, but the elasticity is about the same. In addition, we present evidence that lower ownership, combined with concentrated outside holdings, leads to a reduction in the agency costs of managerial control. We conclude that the patterns of ownership in part represent a tradeoff by venture capitalists between the benefits of incentives and the agency costs of control.

Keywords: Equity; Ownership; Motivation and Incentives; Initial Public Offering; Investment; Venture Capital; Managerial Roles; Cost Management; Governance Controls; Executive Compensation;

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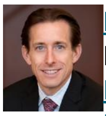

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