

Changing CEO before IPO may raise valuation

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New research from Rice University's Jones Graduate School of Business shows that a change in leadership before a startup's initial public offering (IPO) can increase its valuation and performance.

Yan "Anthea" Zhang, professor and the Fayez Sarofim Vanguard Chair of Strategic Management at the Jones School, and co-author Salim

Chahine of the American University of Beirut analyzed data from 1,156 [venture capitalist](#)-backed IPOs to test a theoretical model on how VC monitoring affects startups' decisions on leadership.

"Changing CEO prior to IPO is necessary to many startups because the environment of a public-listed company is different from and more complex than that of a [startup](#)," according to the study, which was published in the *Strategic Management Journal*. "Firms preparing for IPO need to assemble a broad range of managerial capabilities to deal with the more complex environment after IPO."

VCs tend to pay special attention to a startup's leadership, the authors noted, because compared with mature corporations, "startups typically do not have well-established organizational structures, procedures or policies, and rely heavily on the specific individuals in key positions."

VCs can monitor the startups they're backing in two ways, according to the paper: direct monitoring, in which VCs are involved on-site, and indirect monitoring, in which they rely on the startup's CEO and top management.

A CEO's "human capital"—experience and capability in the job—is crucial to the success of indirect monitoring, according to the research. CEOs with a low level of human capital are more likely to be replaced with someone the VC trusts under such monitoring.

The authors expect the research to be an important contribution to future entrepreneurship literature.

"Our framework explains how VCs achieve the delicate balance between pros and cons of replacing CEOs in their portfolio firms," they wrote. "By controlling for the endogeneity of VCs' decisions on CEO change in their portfolio firms, we provide strong empirical evidence on the

benefits of CEO change in VC-backed firms before their IPO."

More information: Salim Chahine et al. Change gears before speeding up: The roles of Chief Executive Officer human capital and venture capitalist monitoring in Chief Executive Officer change before initial public offering, *Strategic Management Journal* (2020). [DOI: 10.1002/smj.3197](https://doi.org/10.1002/smj.3197)

Provided by Rice University

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