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Report

Understanding Innovation, Entrepreneurial Ventures and Finance in Europe and the World

2nd European Joint Conference of the Academy of Entrepreneurial Finance (Europe) and the Academy of Behavioral Finance & Economics

Patrick Roger and Tereza Tykvová

From 15 to 17 March 2017, Stuttgart was hosting the 2nd European Joint Conference of the Academy of Entrepreneurial Finance (Europe) and the Academy of Behavioral Finance & Economics. The event was organized by the University of Hohenheim and co-hosted by the "Thematic Network Innovation, Entrepreneurship and Finance (INEF)". 58 participants from 13 different countries gathered in Stuttgart to discuss latest academic research in the areas Entrepreneurial Finance and Behavioral Finance & Economics. The event took place at L-Bank, Stuttgart and was sponsored by L-Bank, Boerse Stuttgart and Stuttgart Financial and Sparkassen Finanzgruppe – Wissenschaftsförderung.[1]

On Wednesday evening, 15 March 2017, conference participants had the possibility to attend the welcome reception at Stuttgart Stock Exchange. At the event, *Ulli Spankowski* (Stuttgart Financial) introduced Stuttgart Stock Exchange and gave insights on the activities in the area of entrepreneurship and start-up financing, which led to engaging discussions with the attendants.

The conference continued on Thursday, 16 March, with welcome speeches by *Tereza Tykvová* (Conference Chair, University of Hohenheim and INEF Network), *Robert Jung* (Vice-dean for research, Faculty of Business, Economics and Social Sciences, University of Hohenheim), *Guido Mantovani* (HERMES Universities, Strasbourg and INEF Network) and *Ali Fatemi* (Academy of Behavioral Finance & Economics, DePaul University, Chicago). Afterwards, the participants presented research papers in academic parallel sessions for Entrepreneurial Finance and for Behavioral Finance & Economics. An academic keynote speech by *Jürgen Huber* (Professor of Empirical Economics at the University of

[1] Conference Chairs were *Tereza Tykvová* (University of Hohenheim, INEF Network) and *Patrick Roger* (EM Strasbourg Business School, University of Strasbourg, INEF Network). Local organizing committee consisted of *Tamara Almeyda* (INEF Project Coordinator), *Hans-Peter Burghof*, *Monika Gehde-Trapp*, *Andreas Kuckertz* and *Tereza Tykvová* who were supported by the HERMES network, the AEF Europe as well as the Academy of Entrepreneurial Finance and the Academy of Behavioral Finance & Economics.

Innsbruck) and a practitioner's keynote speech by *Harald Poth* (investment manager at LBBW VENTURE CAPITAL GmbH) added interesting views and delivered stimulating talks.

On Friday, 17 March, the conference continued with academic parallel sessions and the "Best Paper Award" ceremony. The Best Paper Award in Entrepreneurial Finance went to "The Electoral Cycle of Government Venture Capital Investments" by *Fabio Bertoni* and *Anita Quas* (both EMLYON Business School). The Best Paper Award in Behavioral Finance & Economics went to "Surprise in Short Interest" by *Pavel Lesnevski* (University of Mannheim) and *Esad Smajlbegovic* (Erasmus University Rotterdam).

All in all, the 2nd European Joint Conference of the Academy of Entrepreneurial Finance (Europe) and the Academy of Behavioral Finance & Economics encouraged the exchange of knowledge and experiences among academics and practitioners. High-quality papers, interesting presentations and fruitful discussions contributed to the addressing of relevant research issues in entrepreneurial and behavioral finance.

I. Keynote Speeches

The first keynote speaker, *Jürgen Huber* (University of Innsbruck), delivered a stimulating presentation on the link between investors' risk perception and asset prices. This talk was exciting for at least two reasons. First, he and his co-authors obtained original results, at odds with standard finance theory. Second, the paper he presented was based on experiments performed in the controlled environment of the laboratory.

The two main results presented by Jürgen Huber were 1) the variance of returns is far from being the best measure of perceived risk, and 2) risk, as perceived by individuals, impacts market prices. Concerning (1), the authors first show that assets with the same expected return and the same variance of returns trade at very different prices. They demonstrate that the essential reason for this different prices lies in the probability of loss, which is a much better measure of perceived risk. The probability of loss explains 95 % of the perceived asset risk, which in turn explains 95 % of the variation in average asset prices. In other words, it is time for asset pricing models to go beyond the standard CAPM and Fama-French like models and to come back to the basic question. What does the word "risk" refer to in the brain of investors, in particular retail investors?

The research presented by Jürgen Huber makes a significant contribution to the way finance theory should explain market prices and asset returns. It was highly appreciated by conference participants and gave rise to a number of questions showing the interest of the topic for researchers in finance and portfolio managers as well.

In the second keynote "Some More Philosophical Thoughts about Venture Capital from the Buyside: Venture Capital is More an Art Form than Business", *Harald Poth* (LBBW) provided the audience with the practitioner's view on the current state of the venture capital industry in Germany and in Europe. He offered not only many interesting statistics and comparisons, but he also described the challenges that investment managers face when they select, evaluate, support and exit entrepreneurial ventures. Hereby, he stressed the importance of intuition and experience in venture capital investors' decisions. With many interesting and relevant examples from his daily business as an investment manager, who has been working since 16 years in the area of life science and healthcare, he enriched the conference and provided the participants with interesting ideas for new research topics.

II. Track "Entrepreneurial Finance"

The first academic session on entrepreneurial finance covered boards and governance. In their paper "Stubborn and Persistent: The Evolution of Slack Resources in Firms", *Jürgen Hanssens* (Ghent University), *Marc Deloof* (University of Antwerp and Antwerp Management School) and *Tom Vanacker* (Ghent University) provide a theoretical perspective and an empirical evidence on the evolution of slack levels in firms. The starting point of the model is a stable component in the slack level. They propose that this stable component reflects a founder-CEO imprint. They expect the relationship between initial slack levels and future slack levels to be weaker after founder-CEOs are replaced. Empirical evidence from Belgium firms supports the theoretical predictions.

Stephen Ferris (University of Missouri), *David Javakhadze* (Florida Atlantic University) and *Yun Liu* (University of California) examine the effect of boardroom social capital on board compensation in the US. The paper "Corporate Demand for External Connectivity: Pricing Boardroom Social Capital" concludes that social capital (measured as social networks of outside directors) is positively priced. This effect is more pronounced for firms that suffer adverse effects. Socially connected directors more frequently hold board leadership positions and multiple directorships.

In the paper "Entrepreneurial Identity and Signaling: Founder CEOs and New Venture Media Coverage", *Johannes Kolb* (University of Hohenheim) and *Michael Howard* (Texas A&M University) explore the interplay between founder CEOs and media coverage and their effect on firm performance within a sample of US biotechnology new ventures. They find that founder CEOs enhance volume and positive tonality of media coverage, which, in turn, increases the likelihood of firm initial public offering (IPO).

The second session was devoted to performance and investments. The paper "Role of Strategic Alliances in VC Exits – Evidence from Biotechnology", *Leonhard Brinster* (University of Hohenheim), *Tereza Tykvová* (University of Hohenheim) and *Christian Hopp* (RWTH Aachen) contributes to our understanding of the role strategic alliances play in exits of venture-backed biotechnology companies in the US. The authors confirm a positive effect of alliances, which was documented in prior literature, only for IPOs, but not for M&As. Their findings are consistent with the view that strategic alliances help venture-backed companies to certify their quality towards new investors.

In his paper "New Venture Investment Dynamics – A Longitudinal Study", *Reinhard Schulte* (University of Lüneburg) focuses on investment trajectories of new enterprises. He models the trajectory of new venture investments in the first years after market entry and shows a first investment peak at market entry. The second peak occurs on average nine years later.

In their paper "Venture Capital is in the Air: the Impact of Venture Capital Monitoring in Europe", *Diego D'Adda* (Università Politecnica delle Marche), *Massimo G. Colombo* (Politecnico di Milano), *Paolo Malighetti* (Università degli Studi di Bergamo), *Anita Quas* (EMLYON Business school) and *Silvio Vismara* (Università degli Studi di Bergamo) test the monitoring effect of venture capital (VC) financing on portfolio companies in Europe. As an exogenous source of variation, they rely on the idea developed by Bernstein *et al.* (2016)[2] and exploit the introduction of a new airline route between investor and investee locations. They find that VC monitoring has a positive and economically relevant effect on European portfolio companies.

Syndication among VC investors was the topic of the third academic session. The paper "Better Safe than Sorry? The Effect of Trust on Venture Capitalists' Choice of Syndicate Partners" by *Carolin Helmreich* and *Eva Lutz* (both Heinrich-Heine-University Düsseldorf) deals with the impact of bilateral trust among nations on the formation of multinational syndicates. The authors find a positive impact. The magnitude varies with the characteristics of the VC industries in the investor and investee countries.

Elisabeth Berger and *Andreas Kuckertz* (both University of Hohenheim) examine what combination of deal resources accumulated by VC firms leads to high performance. Their paper "Overcoming the Matthew Effect in Status Dominated Environments – a Configurational Analysis of Venture Capital Investments" focuses on the question how new entrants, that have a low status position and weak ties with current actors, can overcome the burden of "being new".

[2] Bernstein, S., X. Giroud and R.R. Townsend (2016). The Impact of Venture Capital Monitoring. The Journal of Finance 71(4): 1591–1622.

The fourth academic session was devoted to investment decisions and valuation. In the paper "A World of Difference? The Impact of Corporate Venture Capitalists' Investment Motivation on Startup Valuation", *Andreas Köhn*, *Patrick Röhm*, *Andreas Kuckertz* (all University of Hohenheim) and *Hermann Dehnen* (RWTH Aachen University) challenge the view that corporate VC investors form a homogeneous group. They categorize them into subgroups by examining their levels of strategic and financial investment motivation and illustrate how startup valuations differ across different investor types.

Francesca Di Pietro (LUISS Guido Carli University), *Francesca Masciarelli* (University G. d'Annunzio) and *Andrea Prencipe* (LUISS Guido Carli University) relate country's linguistic usage to the early stage investments' decisions. In their paper "Responsible investment or Risky bet? The Role of Language in Influencing Investment Decisions in Early-Stage Companies" they show how language future-time-reference and country's linguistic fractionalization correspond to VC and crowdfunding investments.

The paper "The Electoral Cycle of Government Venture Capital Investments" by *Fabio Bertoni* and A*nita Quas* (EMLYON business school) investigates how electoral investments cycles affect the timing, characteristics and performance of governmental VC fund investments. Consistently with the reverse electoral investment cycle, these investors decelerate their investment activity in election years. However, in high-stakes election years, these investors accelerate, consistently with the existence of an opportunistic electoral investment cycle, and exhibit style drift. Companies invested in these years grow less and are less likely to be exited.

The fifth session focused on debt financing in entrepreneurial firms. *Marc Deloof* (University of Antwerp and Antwerp Management School), *Maurizio La Rocca* (University of Calabria) and *Tom Vanacker* (Ghent University) analyze the effects of local banking development on the use of debt financing by Italian start-ups. In their paper "Local Banking Development and the Use of Debt Financing by Start-ups", they find that start-ups use more debt financing if they are located in a province with more bank branches relative to population. They provide a nuanced evidence on the role of national banks, local cooperative banks and foreign banks.

Markus Merz and *Jan Riepe* (both University of Tuebingen) exploit the setting of marihuana industry in the US with conflicting federal and state laws that prohibit banks from engaging in business contracts. In their paper "Access to Banking and its Value in Developed Countries: Evidence from the U.S. Marijuana Industry" they use an event study to document that banks bear an incremental value to young firms. They find that banks cannot be fully substituted by a good institutional environment or by other financial intermediaries.

The paper "Productivity Growth in the Financial Crisis: Evidence from a Sample of Entrepreneurial Firms" by *Christian Thomann* (KTH, Royal Institute of Technology), *James R. Brown* (Iowa State University) and *Gustav Martinsson* (INDEK, KTH, Royal Institute of Technology) analyzes whether and how the recent financial crisis affected productivity growth in Sweden. They show that the financial crisis exacerbated the ongoing productivity slowdown by raising borrowing costs for small, private entrepreneurial firms.

Stock markets were at the core of the sixth academic session. *Alessandro Sapio* (Parthenope University of Naples) and *Valérie Revest* (Université Lumière Lyon 2) argue that stock markets may support the birth of new firms because they promise stock market liquidity. In their paper "The Creation Function of a Junior Trading Venue: An Empirical Test on the Alternative Investment Market" they find that sectors raising more capital at the Alternative Investment Market in the UK have more entrants in the subsequent years.

The paper "SPACs: Post-merger Survival" by *Milos Vulanovic* (EDHEC Business School) focuses on Special Purpose Acquisition Companies (SPACs), which are financial vehicles that conduct the IPO with the solely aim to merge with a private company. The study analyzes how institutional characteristics of SPACs are related to their post-merger survival.

Julius Tennert (University of Hohenheim), *Marie Lambert* (HEC Liège) and *Hans-Peter Burghof* (University of Hohenheim) explore in their paper "Moral Hazard in VC Finance: More Expensive than you Thought" exogenous and endogenous risks in venture-capital financed projects and how these two types of risks affect VCs' wealth. They apply a real options approach to analyze the VC decision with regard to the exogenous risk and a principal-agent framework to deal with the endogenous risk.

The seventh session covered several issues. The paper "Portfolio Allocation and the Cost of Capital of Entrepreneurial Projects: Theory and Policy Implication" by *Thomas Bonesire* (HEC Liège, University of Liège), *Roland Gillet* (Université Paris 1 Panthéon-Sorbonne) and *Georges Hübner* (HEC Liège) models a situation, in which an underdiversified entrepreneur considers financing her own business project, which is subject to illiquidity and high risk. They find that decreasing the entrepreneur's investment in the project has the biggest impact on reducing the cost of capital. They conclude that providing external financing is the most efficient public policy instrument to support entrepreneurs.

Egle Vaznyte (Ghent University), *Petra Andries* (Ghent University) and *Sarah Demeulemeester* (KU Leuven) find in their paper "Disentangling the Link Between Product Relatedness, Parental Hostility, and Spin-Off Performance", using a sample of German companies, that spin-offs producing related products to their parents' offering are more likely to face parental hostility, which in turn positively affects spin-off innovation performance.

In her paper "The Effect of Women Directors on Innovative Activity and Performance of Corporate Firms – Evidence from China" *Marina Töpfer* (University of Hohenheim) elaborates on the question whether women in corporate boards are related to higher firm innovative activity and better performance in China. She finds positive effects associated with gender diversity in corporate boards on firm performance.

The final session was devoted to entrepreneurial activity. *Jisok Kang* (University of Cambridge) examines in his paper "Stock Market Concentration, Entrepreneurship, and Economic Growth" whether and how concentrated stock markets are related to economic growth. His findings suggest that stock market concentration in a country is negatively associated with capital allocation efficiency, which results in sluggish IPO activity, innovation and economic growth.

Finally, in the paper "Impact of Spousal Migration on Entrepreneurial Activity of Left-Behind Female Spouse" *Abhishek Saurav* (George Washington University, The World Bank) analyzes how spouse temporary migration is related to left-behind wives' entrepreneurial activity in Romania. The author finds a positive effect on entrepreneurial activity. On the contrary, left-behind spouses who were return-migrants themselves tend to be less likely to be self-employed or employers.

III. Track "Behavioral Finance & Economics"

The first session dealt with gender, culture and personality traits. The first paper deals with an important and up-to-date question: "Are Women more Risk Averse than Men?". *Razan Salem* (Anglia Ruskin University) presented this original empirical study realized in the Middle East, more precisely in Saudi Arabia, and confirms on her sample the usual result obtained in a number of other countries.

The second paper, "Leading-by-Example and Third-Party Punishment: Behavioral Evidence", by *Reka Heim* (Danube University) and *Jürgen Huber* (University of Innsbruck), reports the results of an experimental study where a supervisor lies between the dictator (who decides how much to transfer) and the recipient (who receives from the dictator). The authors get a leading-by-example behavior and show an in-group favoritism, the dictator transferring more of his endowment when the group is fixed.

The last paper of the session was entitled "Cross-Border Acquisitions and Dyadic Distance", presented by *Edward Lawrence* (Florida International University), co-authored by *M. Raithatha* (Indian Institute of Management) and *I. M. Rodriguez* (Florida International University). The authors study how dyadic distance influences the initiation, completion and duration of cross-border deals. Using a sample of 173,616 cross-border deals announced between 1970 and

2016, they find evidence that cross-country differences in culture and geographical distance influence the initiation of cross-border deals. Differences in culture and institutions influence the completion of deals and idiosyncratic factors also play an important role in determining the duration of the deals.

The second session was devoted to behavioral biases and investment performance. Two of the three papers focused on retail investors, the third one on fund managers. *Marie-Hélène Broihanne* (University of Strasbourg), presented "Appetite for Information in Mandatory profiling of Individual Investors", a paper co-authored with *Anthony Bellofatto* (Catholic University of Louvain). Their paper benefits from an original database constituted of retail clients' accounts of a Belgian online brokerage house and the answers of these clients to two separate MiFID questionnaires corresponding to the appropriateness and suitability tests of the MiFID directive. The paper shows that different levels of appetite for information generate different trading behaviors. Investors who voluntary ask for more financial information, thus revealing a particular personality trait, tend to behave more like "high quality investors". They trade a broader universe of stocks, hold a more diversified portfolio, execute less daytrades and invest more in funds.

The second paper of this session was "Does Households' Wealth Predict the Efficiency of their Asset Mix? Empirical Evidence". The authors, *Andreas Oehler* and *Matthias Horn* (both Bamberg University), address the important topic of the relationship between wealth and asset allocation. The authors use the Panel on Household Finances (PHF), a survey by Deutsche Bundesbank, to show that wealthy investors do not build more efficient portfolios than less wealthy investors. In fact, the main drivers of the efficiency of the asset mix are the gender and the household's risk attitude.

The final paper of this session focused on the link between fund performance and the overconfidence of the fund manager. It was entitled "Fund Manager Active Share, Overconfidence and Investment Performance" and presented by *Arman Eshraghi* (University of Edinburgh). The author uses, as a measure of overconfidence, the active share calculated as the magnitude of the deviation from the benchmark index. The analysis of 2740 funds during the 1980–2009 period reveals that confidence increases following superior past performance but acquiring excessive confidence penalizes future performance. Moreover, investors react in an irrational way, investing more in funds with good past performance without a symmetrical reaction for poor performers.

The third session of the track was devoted to investor sentiment and group decisions. The first paper, "Mutual Fund Flows and Investor Sentiment" presented by *Egle Karmaziene* (University of Groningen), shows that the well-known relationship between fund flows and performance strongly varies with investor sentiment. In particular the link is much stronger in optimistic periods and for funds that usually receive less demand.

The second paper, “Investor Sentiment and Return Predictability: the Power of Ignorance”, presented by *Catherine D’Hondt* (Catholic University of Louvain) and *Patrick Roger* (University of Strasbourg), uses a large database of retail investors’ accounts and answers to MiFID questionnaires to build a sentiment index that help to predict returns on long-short size-based portfolios. The main result of the paper is that the predictive power of the sentiment index is much better when it is built with the portfolio dynamics of the subset of the less informed, less wealthy and less diversified investors. In short, the authors show that the behavior of “noise traders” carries relevant information about stock mispricing.

The last paper of this session, “Responsibility Sharing, Beliefs and Risk Taking”, presented by *Kremena Bachmann* (University of Zurich), reports the results of an experiment testing whether responsibility sharing reduces the emotionally motivated aspiration to bias beliefs toward previous decisions and whether this influences the subsequent investment behavior. The results suggest that decision-makers tend to form beliefs that justify the previous investment decisions. A stronger risk taking motivates more optimistic beliefs, in particular if it leads to losses. Sharing the responsibility for the risk taking reduces the bias in beliefs and helps decision-makers to reduce the risk-taking and limit losses. The results show that there is a beliefs channel, which explains why investors find it easier to realize losses with actively managed funds than losses with stocks.

The final session of the behavioral finance track was devoted to information and incentives. The first paper, “Incentives of Financial Analysts: Trading Turnover and Compensation”, presented by *Egle Karmaziene*, focuses on the long-standing problem of the potential conflicts of interest faced by financial analysts. The author finds that analysts are not compensated for covering stocks with high turnover; their income increases only in the form of abnormal turnover that their research generates for the broker. In line with studies showing that young analysts are better off herding than issuing bold research, the author shows that brokerage houses only compensate more experienced analysts for influential research.

In the second paper “Surprise in Short Interest”, the authors *Pavel Lesnevski* (University of Mannheim) and *Esad Smajlbegovic* (Erasmus University of Rotterdam), propose an intuitive proxy of informed short selling: surprise in short interest. This measure accounts for important cross-sectional differences in short selling. Stocks with a positive surprise in short interest significantly underperform stocks with a negative surprise in short interest. Moreover, the return spread is not explained by standard stock characteristics or short-sale constraints. The surprise in short interest also predicts future surprises in company fundamentals. Finally, in line with the limits-to-arbitrage argument, the return predictability is stronger among illiquid and volatile stocks.

The final paper, "Investor Attention to Stock Recommendations", was co-authored by *Patrick Herbst* and *Konstantinos Gavriilidis* (University of Stirling) and *Anastasios Kagkadis* (Lancaster University Management School). They investigate the explanation of the post-recommendation price drift through the role of investor attention to stock recommendations. They construct a measure of attention to stock recommendations based on the abnormal trading volume on the day of the recommendation. Their findings suggest that stock recommendations, which attract high investor attention, consistently generate more pronounced post-announcement drifts than recommendations which receive little attention on behalf of the investors. Moreover, the authors provide evidence that this phenomenon is mainly driven by upgrades rather than downgrades.