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Market catalysts, like incubators, science parks, and junior stock exchanges, are created with the intention of stimulating venture creation and economic growth. However, a study published in the Strategic Management Journal shows that intermediaries have un-intended negative consequences. Bob Eberhart, a graduate of Stanford's Department of Management Science and Engineering, and Charles Eesley, an Associate Professor in Stanford's Department of Management Science and Engineering, analyzed the performance of over 19,000 firms in Japan. Their study shows that increased competition and information asymmetry unintentionally led to fewer quality IPOs and ultimately less economic growth.

The Dark Side of Institutional Intermediaries: Junior Stock Exchanges and Entrepreneurship

Transcript

- Increasingly, governments around the world are focusing on high tech entrepreneurship as a mechanism to stimulate job creation and economic growth.. At a high level, people have been focused a lot on barriers to entry.. So, decreasing the regulatory steps to starting a firm or the financial capital that's required to get started.. This paper is about the dark side of institutional intermediaries, and in particular we're looking at junior stock exchanges.. - The key question was how do intermediaries intended to help the development of firms assist their growth and does it benefit them? We looked at Japan because they put in place in the year 2000 several new stock exchanges intended to copy the success that they perceived of the NASDAQ market here in the United States.. In fact, one was even named JASDAQ, just to make the point.. And these were markets that copied the third tier of the NASDAQ market in the United States.. These are new companies across all industries where the new stock exchanges put in place and saw how their growth was affected by putting in those exchanges.. Let's take a look at how the junior stock exchange intermediary changes the virtuous cycle.. The new junior exchanges make a wider gate and provide a new pathway for companies to obtain an IPO..

It lowers financial standards for listing, admits more marginal companies, and restricts access to technology firms.. This creates incentives for investing in tech companies.. Early investors now faced with more options heavily skewed towards tech, fund more new tech companies and fewer non-tech companies, which may have had better potential.. Some of the companies do well.. Some of the companies don't.. But now with more competition and more marginal companies, only some do okay, but overall there are more flops.. Companies still reach successful IPOs in both exchanges but there are fewer quality IPOs and the IPOs return less money to the early stage investors.. Thus the intermediated cycle produces more firm activity but also increases competition, yields fewer high growth companies, fewer returns and less capital to reinvest.. The virtuous cycle is disrupted.. Despite increased activity, the intermediated cycle is actually less encouraging for successful firm development..

One of the things I think that's central to the paper is this idea of decoupling.. So the paper tries to make the point that intentions can be decoupled from outcomes.. We intend this to help and our first guess, that these will create economic incentives but it doesn't anticipate the other effects, that people will act differently, change the way their investment patterns, and hence change the growth patterns of companies.. - From the perspective of an entrepreneur or an investor, the implication of the paper is to be careful when you're reacting to changes that the government or some outside entity is doing to try to encourage entrepreneurship.. I hope that others will build on this work.. One way to build on it might be to look at other types of institutional intermediaries or other types of policies that are being implemented around the world to try to encourage entrepreneurship.. We should pay a lot of attention to any policies that are increasingly becoming a trend because those are ones where we actively need more data and need more evidence of their effectiveness.. It's just as important to focus on the more informal institutions, the social norms, the cognitive institutions, the cultural side.. These are areas that are more difficult to research because it's harder to gather the data but I think increasingly countries are able to copy the regulatory aspects because the policies are written down.. - There's things about entrepreneurship we don't understand and it always should cause skepticism to both the policies we select and what we teach and humble us a little bit when we do studies like this is kind of the central message that we should be careful that we get unintended consequences..

(bright music)..