Editorial

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A firm needs to make financing and listing decisions throughout its life cycle, from its start-up stage (when it may take, e.g., venture capital financing, angel financing, or bank financing), through its initial public offering. Finally, a firm may take a decision to de-list (and may turn to private equity finance). Traditionally, the corporate finance literature has emphasised firm's characteristics, such as investment opportunities, size, leverage, as determinants of the decision to go public and raise equity finance through public offer. Nevertheless, managerial and investor psychological biases have an impact on a firm's financing and listing decisions.

In their review paper, Baker et al. (2004) distinguish between two different approaches of the behavioural corporate finance. The irrational investors approach

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assumes managerial rationality and perceiving managerial decisions as rational response to securities market mispricing. The irrational managers approach assumes investor rationality.

If investors are irrational, the rational managers should issue more shares when stock price is too high, and repurchase shares when stock price is too low. In line with managerial biased approach, Malmendier et al. (2005) explain the pecking order theory from managerial behavioural perspective. The authors argue that over-optimistic managers about the future prospects of their companies believe that their firms are undervalued therefore they perceive external finance as expensive, i.e., overpriced. These managers may underutilise debt relative to tax benefits from interest deductibility. Therefore, these managers follow the pecking order theory of capital structure.

Through its life cycle time, a firm is faced with many managerial behavioural issues that affect its financing and listing decision, and ultimately, its market value. These include agency problem, accounting fraud and investment decision to many others management psychological behaviour that impacts the value of the firm and its ability to raise fund.

The focus of this special issue is on the behavioural factors surrounding a firm's financing and listing decisions at all stages of its life cycle. The first two papers examine the behavioural factors affecting the venture capital performance and entrepreneurial failure. The third paper focuses on the cognitive issues and heuristics that shape the fraudulent behaviour. The last two papers examine the price discovery and share price reaction to the investors' behavioural biases.

The first paper by Fairchild examines the effect of agency problem and behavioural factors on venture capital/entrepreneur contracting and performance. The author develops a game theoretical model in which the venture capitalist and entrepreneur negotiate the distribution of equity share, and then exert value-adding effort when running the business. Nevertheless, the existence of double-sized incentive problem between the investor (the venture capitalist) and the investee (the entrepreneur) leads both parties to exert sub-optimal efforts. Fairchild shows that the increase in social fairness norms encourages venture capitalist to offer more equity to the entrepreneur which induces the entrepreneur to exert more effort. This will improve the performance of the venture.

The second paper by Benson and Han examines the phenomenon of 'entrepreneurial failure' using a sample population of former managing directors of liquidated SME. The paper focuses on the personal characteristics of the entrepreneur. The authors contend that there are many valuable lessons to be learned that may reduce the high mortality rates of the entrepreneurial businesses. The reasons of business failure can fall into two-broad areas which are the failure to fund or/and the inability to learn. The paper provides an insight into reasons for the entrepreneurial business failures from the viewpoint of those who were closely involved in such business failure. This will be useful for nascent entrepreneurs and their advisors to be aware of the likely personal risk they are assuming before starting their new business venture.

The third paper by Kleiman and Anandarajan examines how cognitive heuristic can be used to explain accounting fraud. The authors extend the factors that are normally considered in explaining potentially fraudulent behaviours by including psychological and related variables. The authors use the 'fraud diamond' to develop a model to illustrate how cognitive biases can influence fraudulent decision-making. The authors show that management can perpetrate fraud because their biases influence their judgement to the means and opportunities. The same biases affect the ability of the individual considering committing the fraud to resist rationalisation.

Focusing on the information content of quotation signal, the fourth paper analyses the price discovery with and without the trading. The author uses the pre-opening quotes in the absence of trading, and the day-trading quotes in the presence of trading. The paper finds that the non-trading mechanism plays an important role in the price discovery process. The non-trading mechanism is able to reduce the noisiness and improve the efficiency of stock prices in the pre-opening.

The fifth paper by Sridhar et al. examines the momentum return from portfolios constructed using NYSE-AMEX stocks. The paper finds that momentum portfolios gain significant higher return in the six-month period following the formation period, whereas loser portfolios earn return above zero during the period. In addition, the paper finds that higher returns to the winners occur mainly in the down markets and a significant reversal in the momentum returns is observed in the month of January. The results of the paper do not support the overreaction or under reaction hypotheses of momentum returns.

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