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Up Close and Personal with Delaware

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Delaware's investors from various states is needed as a lingua franca that A close analogy is the use of state law. In short, Delaware law all speak home state (or third startups receive out-of-state different U.S. states. The more function for investors from ferent U.S. states. This finding and others strongly supportive of our investor familiarity hypothesis.

Our most salient empirical results are as follows. First, we found that the race for VC-backed startup charters is a "bi-modal" race between Delaware and the startup's home state. Only a small percentage of startups in our sample chose to incorporate or reincorporate in a state that was not either Delaware or the startup's home state. Second, in this bi-modal race, Delaware beats the home state handily. Almost 80 percent of startups choose Delaware as their initial state of incorporation, versus nearly 29 percent choosing their home state. When incorporations and reincorporations are combined, we find that 79 percent of the firms in our study ultimately chose Delaware.

Third, out-of-state investors have more impact on choice of domicile than in-state investors. For example, moving from one out-of-state investor to four or more out-of-state investors after the initial round of financing is associated with an approximate 17 percent increase in Delaware incorporation. By contrast, the same increase in the number of in-state investors only increases Delaware incorporation by approximately 2 percent. Thus, it is not the number of investors that matter, but rather their location. This finding and others like it, detailed in the paper, are strongly supportive of our investor familiarity hypothesis.

The normative implications of our findings are both positive and negative. On the positive side, familiarity with Delaware law may make it easier for corporate lawyers to negotiate a complex financing arrangement at low cost to the client, poten­tially lowering the overall cost of capital. On the other hand, because of familiarity Delaware law may still be chosen even if it is not the "best" law. Familiarity may create a barrier to another state seeking to compete with Delaware, hindering desirable state-level innovation. A competing state would not only need to provide better law, but it must also overcome the lack of familiarity that may prevent parties from adopting the alternative law.